PUBLIC VERSION

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Library of Congress
Washington, D.C.

In re	)	
DETERMINATION OF ROYALTY RATES AND TERMS FOR EPHEMERAL RECORDING AND DIGITAL PERFORMANCE OF SOUND RECORDINGS (*WEB IV*)	)	**DOCKET NO. 14-CRB-0001-WR (2016-2020)**

REPLY PROPOSED FINDINGS OF FACT OF SOUNDEXCHANGE, INC.

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I. INTRODUCTION

1. The parties in this proceeding have submitted very different rate proposals. SoundExchange proposes rates for the 2016-2020 rate term that increase only modestly from the current statutory rates. The Services, in contrast, demand "significant reduction[s]" in the applicable rates. NAB PFOF ¶ 1 (emphasis in original); IHM PFOF at p.i (asking for a rate "reset").

2. Underlying the differences in these proposals are radically different conceptions of (a) what the controlling statute, 17 U.S.C. § 114(f)(2)(B), commands regarding the hypothetical market; and (b) what the evidence says about the extent to which "interactive" and "non-interactive" service offerings are converging and will continue to converge over the 2016-2020 rate term—and what that means for the rates willing buyers and sellers would agree to in the hypothetical market.

3. Following the clear language of the statute, SoundExchange has presented a benchmark analysis based on "thick market" agreements negotiated by a wide range of willing buyers and willing sellers for rights closely related to (or overlapping with) the rights provided to statutory licensees. What is more, these agreements were negotiated without the direct, overbearing influence of the shadow of the statutory license. And SoundExchange's proposal reflects the fact that consumer use of ad-supported statutory services interferes with and substitutes for consumer use and adoption of higher-revenue generating services—the most significant of copyright owners' "other streams of revenue" over the coming rate term. 17 U.S.C. § 114(f)(2)(B)(i).

4. The Services, in contrast, rely on agreements involving only a few buyers and a small fraction of the sellers whose repertoires even noninteractive services require in order to have viable consumer offerings. The Services' benchmarks were negotiated directly in the

shadow of the statutory license. Indeed, the Pandora-Merlin agreement's rates and terms derive directly from the Pureplay Settlement Agreement; by statute, that makes the Pandora-Merlin agreement inadmissible in this proceeding.[1] The Services focus myopically on their claim that statutory webcasting promotes sales—a proposition for which the record is unclear at best. But the Services ignore the undisputed evidence showing that (a) sales are declining and will continue to decline over the next rate term, and (b) consumer use of statutory services directly interferes with copyright owners' revenues from higher-revenue-generating directly licensed services.

5. No one does or can dispute that webcasting is the here and now and the future of music consumption. The stakes could not be higher for current and future recording artists, the people who help make recordings, and the businesses that underwrite and undertake all the financial risk to produce and distribute the content that fuels the webcasting industry. In light of this reality, it is unsurprising that the parties collectively have submitted many thousands of pages of findings, conclusions, exhibits, and hearing transcripts to the Judges. When all is said and done, it is clear that one party's proposal—SoundExchange's—meets the statute's commands. The Services' proposals do not.

6. SoundExchange consolidates its reply to the Services' voluminous proposed factual findings as follows:

7. Section II demonstrates the Services' fundamental misunderstandings of both the hypothetical market the Judges must consider and the relevant participant and economic inputs from the actual market that must be part of the hypothetical market.

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[1] SoundExchange's Proposed Conclusions of Law ("SX PCOL") demonstrate why § 114(f)(C)(5) bars consideration of the rates and terms of the Pandora-Merlin agreement.

8. Section III responds to the Services' multiple attacks on SoundExchange's rate proposal. This Section demonstrates that those criticisms are unfounded and that SoundExchange's proposal most accurately reflects the rates and terms that willing buyers and sellers would agree to in a market without the statutory license.

9. Sections IV-IX detail the numerous methodological and factual flaws in the rate proposals and findings submitted by, respectively, Pandora, iHeart, NAB, SiriusXM, and the "non-commercial" webcasters.

10. Section X sets forth SoundExchange's responses to the Services' criticisms of SoundExchange's Proposed Terms and Regulations.

II. THE SERVICES' SUBMISSIONS FUNDAMENTALLY MISUNDERSTAND THE MARKETS THAT ARE RELEVANT TO THIS PROCEEDING

11. The Services do not base their submissions on the hypothetical marketplace that must be considered in this proceeding. The Services' conceptions of the hypothetical marketplace do not incorporate the limitations that the statute requires. *See* Section A, *infra*. And the hypothetical marketplace the Services conceive do not incorporate the realities of the actual marketplace, all of which (save for the existence of the statutory license) must be factored into the hypothetical marketplace. *See* Section B, *infra*.

A. The Services' Proposals Fundamentally Misunderstand The Hypothetical Market

1. The Services Focus On Small Numbers Of Buyers And Sellers, Whereas The Hypothetical Market Must *Include* The Broad Range Of Buyers And Sellers; And The Services Focus On Agreements Directly Influenced By The Shadow Of The Statutory License, Whereas The Hypothetical Market Must *Exclude* The Statutory License

12. Section 114(f)(2)(B) requires the Judges to "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." "The Act instructs the Judges to use the willing

buyer/willing seller construct, assuming no statutory license." *Webcasting III Remand*, 79 Fed. Reg. 23102, 23107 (Apr. 25, 2014). The "hypothetical" in the hypothetical marketplace is that "no statutory license exists." *Web II Final Order*, 72 Fed. Reg. 24084, 24087 (May 1, 2007). In all other respects, the hypothetical marketplace mirrors the actual marketplace. *Id.*

13. The Services ask the Judges to assume a hypothetical marketplace that deviates from the foregoing requirements in two critical respects.

14. First, the Services proffer benchmark agreements involving a single buyer—either Pandora or iHeart, as the case may be in their respective Proposed Findings—and one seller (or a group of sellers that collectively represent a distinct minority of all sellers). The Services claim that these benchmarks reflect the workings of the hypothetical marketplace, even though the agreements indisputably confer "first mover" advantages that the service/buyer cannot replicate across the broad range of copyright owners/sellers. *See* PAN PFOF ¶ 88 ("Pandora's primary benchmark—the Merlin Agreement—presents the Judges … with a competitive, arm's length direct license between a statutory licensee and a significant number of record companies.") (that "significant number of record companies" accounted for [ ] pre-agreement, and [ ] post-agreement, *see* Hr'g Ex. PAN 5022 at 26 (Shapiro WDT); Hr'g Tr. 4236:2-6 (May 18, 2015) (Herring)); IHM PFOF ¶ 169 ("for the first time there is ample evidence of rates and terms that were *actually* negotiated by such parties, including iHeartMedia's agreement with a major record label, Warner; [and] its agreements with 27 independent labels") (iHeart's data [ ], Hr'g Ex. SX-29 ¶ 84 (Rubinfeld Corr. WRT)).

15. The hypothetical market does not consist of one buyer and one seller (or a group of sellers comprising but a sliver of the market). "The 'buyers' in this hypothetical marketplace are *the Services (and other similar services)*," and "[t]he sellers in this hypothetical marketplace are *record companies*." *Web II Final Order*, 72 Fed. Reg. at 24087 (emphasis added); *id.* at 24091 ("Any cognizable entity smaller than the record companies makes little sense because, in such cases, the larger buyers among the Services would enjoy disproportionate market power resulting in below-market prices."); *Web I Final Order*, 67 Fed. Reg. 45240, 45244 (July 8, 2002) ("the willing buyers are the services which may operate under the webcasting license (DMCA-compliant services), the willing sellers are record companies"). "In the hypothetical marketplace we attempt to replicate, there would be significant variations, among both buyers and sellers, in terms of sophistication, economic resources, business exigencies, and myriad other factors." *Web II Final Order*, 72 Fed. Reg. at 24087.

16. Second, the Services deviate from the statutorily mandated hypothetical market because their proffered benchmarks are all heavily influenced by the statutory license—which is the one respect in which the hypothetical market must differ from the actual market. All of the agreements that Pandora and iHeart submit were negotiated directly in the shadow of, and thus heavily influenced by, the statutory license. **Pandora-Merlin**: *See* SX PFOF Section VIII.B.1; Section IV.C, *infra*; Hr'g Tr. 4571:9-14 (May 19, 2015) (Shapiro) [redacted]; Hr'g Tr. 4583:22-24 (May 19, 2015) (Shapiro) (Pandora-Merlin Agreement is "definitely negotiated in the shadow of the pureplay rates. No question. It's obvious."); Hr'g Tr. 4262:14-21 (May 18, 2015) (Herring) ([redacted]); *see also* Hr'g Ex. SX-13 ¶ 5 (Lexton WRT) ("In my view, this

license was therefore directly affected and inextricably bound by the existing statutory rates, not evidence of what the next statutory rates should be."). **iHeart-Warner Agreement**: *See* SX PFOF Section III.B.4 (iHeart-Warner); Hr'g Ex. IHM 3034 ¶ 48 (Fischel/Lichtman AWDT) (agreeing that, at least the largest portion of the iHeart-Warner agreement "is directly affected by the existing statutory rates.").

17. The Services' reliance on agreements derived from the statutory license and/or negotiated directly in its shadow violates the cardinal precept of the hypothetical market: that market "assumes no statutory license." *Webcasting III Remand*, 79 Fed. Reg. at 23107; *see also id.* at 23110 ("The hypothetical marketplace is one in which no statutory license exists"); *Web II Final Order*, 72 Fed. Reg. at 24087 (same). Because the hypothetical marketplace between willing buyers and willing sellers depends upon the absence of a statutory license, agreements that are heavily affected by the statutory shadow do not reflect the hypothetical marketplace.

2. The Services' Grounds For Changing The Hypothetical Marketplace The Statute Requires—A Purported "Effective" Competition Requirement And A "Threat Of Steering"—Are Wrong As A Matter Of Law And Fact

18. The Services tacitly recognize that their conception of the hypothetical marketplace is contrary to the statute's command. The Services therefore craft a theory to get around these obstacles. The Services insist that the willing buyer/willing seller standard includes an additional requirement—one not found in the statutory text—of "effective" competition. The purported effective competition requirement, the Services insist, necessarily requires "the ability of a buyer to substitute the product of one seller for that of another—buyer choice." PAN PFOF ¶ 38; NAB PCOL ¶ 692. Based on this conception of what the statute requires, the Services insist that their proposed benchmarks meet the standard of "buyer choice." In particular, the Services claim that their benchmark agreements reflect a service's ability to obtain lower per-

performance rates from a single seller by "threatening to steer" more or fewer performances of that seller's repertoire through the service. PAN PFOF Sections II.A, III.A.2, III.D; IHM PFOF Section II.D; NAB PFOF Section VI.A.

19. There are numerous legal and factual flaws in the Service's arguments. SoundExchange has detailed these flaws in its opening Proposed Findings of Fact and Conclusions of Law, and SoundExchange provides further rebuttal to the Services' arguments in its Reply Findings and Conclusions. This is a brief summary:

20. First, the Services are wrong as a matter of law that the Judges may add to the text of § 114(f)(2)(B) a requirement that the marketplace meet a nebulous standard of "effective" competition. Congress did not grant the Judges the authority to rewrite the statute in this way, and doing so would be legal error. Nothing in the text, structure, or legislative history underlying § 114(f)(2)(B) or the willing buyer/willing seller standard authorizes the addition of such a requirement. Other provisions of the United States Code show that, when Congress meant to direct an administrative body to apply a standard as amorphous as "effective competition," Congress spelled out those requirements precisely. *See* 47 U.S.C. § 543(*l*)(1). Congress obviously did not do that in § 114(f)(2)(B). Nor is there binding precedent from the D.C. Circuit (or any other court) or from prior decisions of the Judges, the Librarian or the Register holding that such a requirement exists. None of the Services' other arguments for engrafting an effective competition requirement onto § 114(f)(2)(B) has merit. *See* SX PCOL Section II; SX Reply COL Section II.A.

21. Second, even if § 114(f)(2)(B) included an effective competition requirement—which it does not—SoundExchange has demonstrated that the benchmark agreements were negotiated in markets in which neither sellers nor buyers have disproportionate market power.

Copyright owners are not price makers, but instead are subject to external constraints on price (most notably, the widespread phenomenon of piracy) and the market power of substantial buyers (including Apple, Google, Amazon.com and Spotify). Accordingly, the marketplace in which record companies negotiate direct licenses for rights with webcasting services is effectively competitive under any reasonable conception of effective competition. *See* SX PFOF Section VII.D; Section III.B.1, *infra*.

22. Third, the Services fail to show that a purported "ability to steer" would have any impact on the consideration charged by a willing seller in the hypothetical market. The evidence instead shows that any "ability to steer" flows largely if not entirely from Services' ability to fall back on the statutory license. Absent the statutory license, the Services would not have the ability to make good on any streering threat, because if a copyright owner/seller decided not to license the service/buyer, then the service would have no access to that owner's repertoire. In addition, there is no evidence that the threat of steering ever has resulted in a price discount. *See* SX PFOF Section VIII.G; Section III.B.4, *infra*.

B. The Services' Proposals Fundamentally Misunderstand The Actual Market

23. The Services' proposals also misunderstand the factual underpinnings and economic realities that must be assumed as part of the hypothetical market.

24. As discussed, the hypothetical market is the actual market minus only the statutory license. Otherwise, the buyers are "*the Services (and other similar services)*," and "record companies" are the sellers. *Web II Final Order*, 72 Fed. Reg. at 24087. These participants exist in a world of economic realities that must be factored into the hypothetical market. The Services either ignore or distort the record evidence concerning these important issues.

25. This Section explains in detail what the record shows and what the law requires the Judges to consider regarding the actual market considerations that bear on the hypothetical market: (1) We briefly summarize the undisputed evidence (which the Services ignore) of the fundamental transformation of the recorded music market from one based on ownership of copies to a market based on access to repertoire through streaming services. (2) We refute the Services' backhanded dismissal of the convergence between statutory and non-statutory offerings; the extent of this convergence is clear, indisputable, and critical to understanding the rates and terms that would prevail in the hypothetical market. (3) We rebut the Services' claim that statutory services are promotional of record company revenues; the evidence is clear and undisputed that statutory services interfere with higher revenue offerings from directly licensed services. (4) We show that the Services' characterizations of themselves as unprofitable are both unfounded and ultimately irrelevant to this statutorily prescribed ratemaking proceeding. (5) We show that the Services' claims about record companies' purported profitability are overstated, misleading, and irrelevant.

1. The Ownership-To-Access Transition Is Critical To Understanding The Rates And Terms To Which Willing Sellers Would Agree In A Market Without The Statutory License

26. We begin with a proposition that the Services cannot credibly challenge and that they therefore ignore: that the record industry is undergoing a transformational shift from consumer ownership to consumer access as the dominant means of consuming music. *See* SX PFOF Section V.B.

27. The evidence is undisputed that sales of both physical albums and permanent downloads have declined and will continue to decline over the coming rate term. Hr'g Tr. 368:4-16 (Apr. 28, 2015) (Kooker) ("at this point, in the public projections that we have put out through our investor relations group, our forecast is that the download business is going to

continue to decline into the foreseeable future"); Hr'g Ex. SX-21 ¶ 28 (Wheeler WDT) ("At Beggars Group, already [ ]."); Hr'g Ex. SX-10 ¶ 11 (Harrison Corr. WDT) ("The most visible example of . . . the market's transition away from an ownership model to an access model is the rapid decline in permanent download sales. January is typically [Universal's] biggest month for download sales because iTunes gift cards are a common holiday gift. In January 2014, however, we saw a 20% decline in download sales from the prior January. Since January, the rate of decline has decreased somewhat from the prior year, but it is still 18% year-to-date.").

28. The evidence likewise is undisputed that consumption on access-based streaming services has grown and will continue to grow dramatically over the coming rate term. Numerous services have entered and continue to expand their presence in the online streaming space. These include some of the largest companies operating in the online space and, indeed, in the economy at large, including Apple, Google, and Amazon. The space also includes services like Spotify, Rhapsody, iHeart Radio, and others that for several years have offered online streaming services. Hr'g Ex. SX-12 at 12-13, 16 (Kooker WDT).

29. As compared to other forms of revenue, including most notably from selling copies of sound recordings, revenue from streaming services accounts for a greater share of record industry revenues each year. Between 2008 and 2013, the proportion of total music industry revenue from all forms of digital streaming services grew from 4% to 21%. Revenue from streaming services to all record companies during the first half of 2014 grew by 28% over the same period during calendar year 2013. Hr'g Ex. SX-12 at 14 (Kooker WDT).

30. The evidence also is undisputed that the shift from ownership to access models has changed the way that copyright owners focus on monetizing their content. In particular, the shift has magnified the importance of monetizing consumption through streaming services. Copyright owners and recording artists are now focused on generating revenue directly from the act of listening to music and not solely from the sale of copies of music.

31. Copyright owners have tried to structure their agreements with directly licensed services to incentivize those services to convert consumers who utilize free-to-listen tiers to higher-average revenue per user ("ARPU") subscription tiers. For example, [ ]. Hr'g Tr. 401:1-403:10 (Apr. 28, 2015) (Kooker).

32. The existence of ad-supported services—in particular, those that operate pursuant to the statutory license—is one of the most significant challenges that copyright owners and directly licensed services face in convert free-to-listen consumers to the higher-ARPU subscription offerings that are necessary to sustain and grow the recorded music business. SX PFOF ¶ 256.

33. The implication of this shift—and of the convergence between "noninteractive" and "interactive" offerings (discussed below)—is clear. Consumers that want to listen to free, custom radio on the internet have multiple choices. Record companies have an economic interest in this choice. A record company is better off if a consumer opts for Spotify's or Apple's free radio tier than if the consumer chooses Pandora. In the hypothetical market, no

rational record company would willingly accept a materially lower rate from a service like Pandora that is in direct competition with services that upsell listeners to more valuable offerings. A significantly lower rate would enable Pandora to grow its free, low-value radio service at the expense of the free radio services offered by Apple and Spotify, platforms that generate more value for the record companies. In the hypothetical marketplace, record companies would not risk their own bottom line by gifting Pandora or any other statutory service with a sizable discount off prevailing market rates.

2. The Convergence Between Statutory And Non-Statutory Services Is Critical To Understanding The Rates And Terms To Which Willing Sellers Would Agree

34. SoundExchange's Proposed Findings of Fact demonstrated that the markets for statutory and non-statutory services are rapidly converging. SX PFOF ¶¶ 257–313. This convergence is a fundamental feature of the market that affects how record companies perceive the value offered by statutory services like Pandora. As SoundExchange's Proposed Findings of Fact concluded: "In the hypothetical market . . . no rational record company would willingly accept a materially lower rate from a service like Pandora that is in direct competition with services that upsell listeners to more valuable products." SX PFOF ¶ 313.

35. The Services contend that no such convergence has occurred. PAN PFOF Section IV.C ¶¶ 273-339; IHM PFOF Section V.D ¶¶ 299-310; NAB PFOF Section III.B ¶¶ 66-81;[2] SXM PFOF Section III.A ¶¶ 29-35. But in making this claim they ignore significant contradictory evidence—evidence drawn from their own course-of-business documents. As Prof. Shapiro, Pandora's expert, conceded, such evidence is more reliable than the Services' litigation positions. Hr'g Tr. 2717:10-15 (May 8, 2015) (Shapiro); Hr'g Tr. 4911:20-25 (May

[2] NAB's arguments are addressed in Section VI, *infra*.

20, 2015) (Shapiro). Subsection A, *infra*, describes this evidence of convergence and demonstrates that statutory and non-statutory services compete head-to-head for the same broad base of consumers.

36. Pandora also contends that convergence is simply irrelevant to this proceeding. According to Pandora, convergence, to the extent it exists, is an artifact of the "downstream consumer market" and does not affect the "upstream" markets for the licensing of services. PAN PFOF ¶¶ 273-280. The evidence shows, however, that as a matter of basic economics, the "downstream" and "upstream" markets are closely linked. A rational record company must necessarily consider the degree to which Pandora cannibalizes listeners from services that generate more value for the record company. Hr'g Tr. 4947:15-4949:7 (May 20, 2015) (Shapiro). Subsections B and C, *infra*, describe the relationship between the upstream and the downstream markets and show that record companies must and do consider the "downstream market" in deciding the rates offered in the "upstream market."

a. Market Evidence And The Services' Ordinary Course Of Business Documents Show Convergence Between Directly Licensed Services And Statutory Services

i. Consumers Value Both Control And Lean-Back Listening

37. Although the services try to draw a sharp distinction between "lean-back" and "lean-forward" listening, the evidence shows that consumers increasingly want services that offer both types of listening on the same platform or service.

38. Pandora's internal research shows that listeners overwhelmingly want [redacted]

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[redacted]

39. Similarly, another Pandora research report indicated that [redacted]. Hr'g Ex. SX-1679 at 17 [redacted].] As Pandora concluded in an internal business deck, [redacted] *See* Hr'g Ex. SX-278 at 7. And [redacted] *Id*

40. Pandora has recognized the clear implications of its product research. [redacted] For example, in an internal strategy document, Pandora recognized that [redacted]

[redacted]" Hr'g Ex. SX-278 at 7.

41. As discussed in the sections that follow, both directly licensed and statutory services have responded to this consumer demand for a range of listening options. Directly licensed services have developed a freemium strategy and have added lean-back offerings (like radio and programmed playlists), while statutory services, in turn, have been exploring ways to push the limits of DMCA functionality to satisfy "consumers' expectations of interactivity and personalization." Hr'g Ex. SX-2369 at 3; SX PFOF ¶¶ 258-295.

ii. Directly Licensed Services Now Offer Lean-Back Listening Features As Part Of Their Broader Platforms

42. In arguing that directly licensed services do not compete with statutory services, the Services assert that directly licensed services are "fundamentally" different because they offer on-demand listening. *See, e.g.*, PAN PFOF ¶¶ 281-289, ¶¶ 307-308; IHM PFOF ¶ 310; SXM PFOF ¶ 32. For example, Pandora contends:

> As a non-interactive service, Pandora offers a 'lean-back,' radio-style listening experience. . . . On-demand services, in contrast, offer a 'lean-forward' listening experience."

PAN PFOF ¶ 281.

43. This claim ignores a key and undisputed feature of today's market—so-called "on-demand" services *do* offer "lean-back, radio-style listening" experiences as part of their broad feature sets. SoundExchange's Proposed Findings of Fact show that numerous competitors, including Rdio, Rhapsody, Slacker, Beats, Amazon, Google, and Apple, now offer a "a variety of free and paid product offerings, including custom radio, curated mood-based playlists, and other passive, lean-back experiences." SX PFOF ¶ 266.

44. SoundExchange's undisputed marketplace evidence is confirmed by Pandora's internal business documents. In an internal presentation, Pandora [

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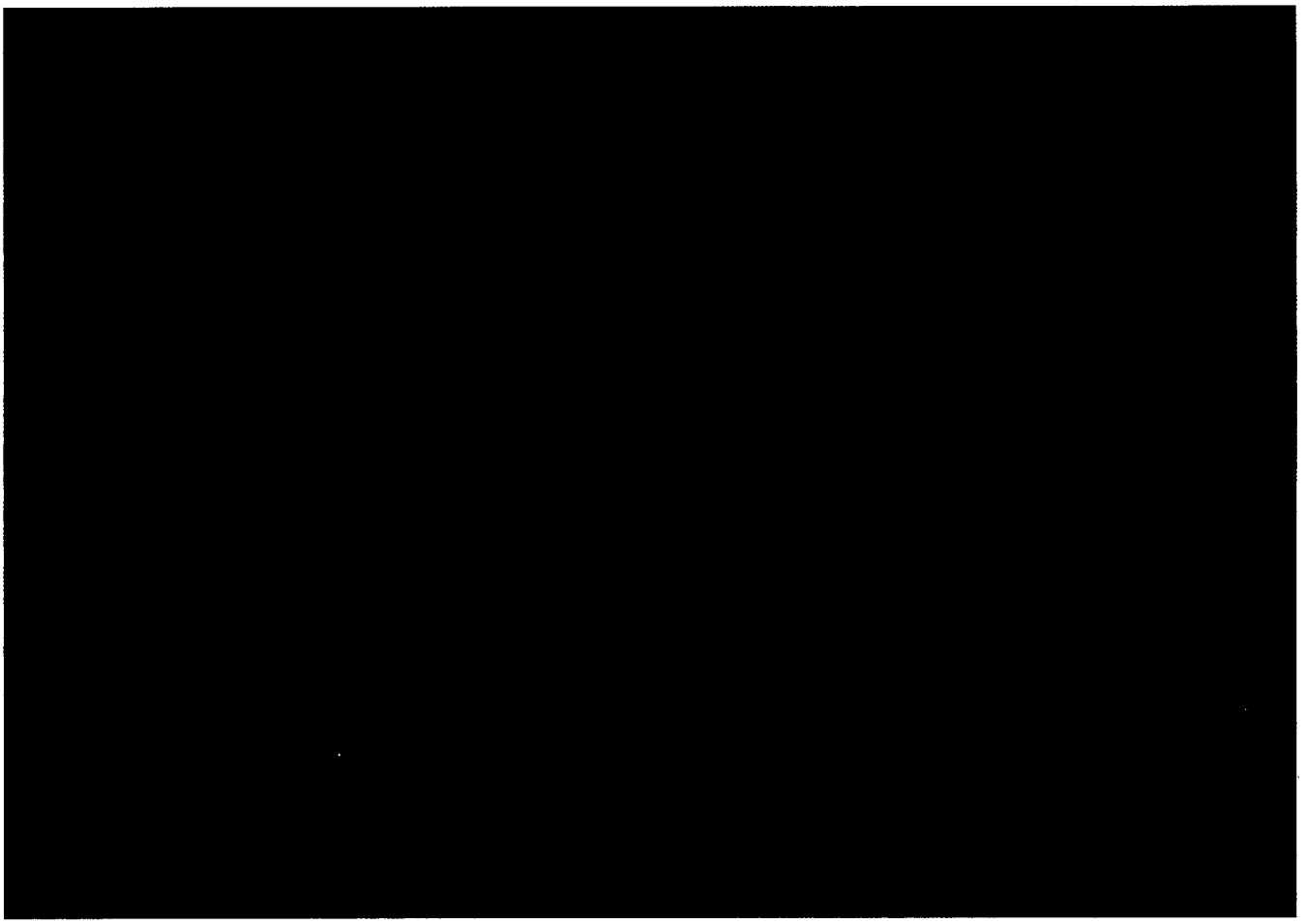

Hr'g Ex. SX-263 at 23.

45. Another internal Pandora document—[ ]—outlined Spotify's offerings. This report plainly recognizes that Spotify [

] Hr'g Ex. SX-1652 at 19. The report also recognizes that Spotify offers [

] *Id.* at 19-

20. Similarly, the [ ] report shows that other competitors like [ ] also offer consumers [ ] *Id.* at 6, 14-15.

46. Pandora and the other Services do not contest that directly licensed services have begun to offer significant lean back offerings. Mr. Herring agreed that so-called "on-demand services" like Spotify "are trying to be more relevant . . . in the lean-back market." Hr'g Tr. 3449:23 – 3450:6 (May 13, 2015) (Herring). He conceded that "Spotify creates playlists, which have more of a lean-back aspect to them." *Id.* at 3450:24 – 3451:3 .

47. Similarly, Mr. Pittman of iHeartRadio agreed that Spotify offers a "platform of music streaming services to music listeners," including "a radio service." Hr'g Tr. 4881:25 – 4882:6 (May 20, 2015) (Pittman). And he agreed that Apple offers iTunes Radio, Beats, and a download store, and that Google has Google Play, Songza, and a download store. *Id.* 4882:24 – 4884:16.

48. Thus, although the Services' Proposed Findings of Fact ignore the lean-back features of directly licensed services, there is no dispute that services like Spotify, Google, and Apple have begun to offer lean-back features as part of their broader platforms. While many of the directly licensed services as chiefly on-demand services, in the past five years these same services have become more and more driven by their programmed playlists. Hr'g Tr. 2542:3-2543:2 (May 7, 2015) (Wilcox); *see also* Hr'g Ex. SX-27 at 15-20 (Kooker WRT). Radio is now used as

49. Moreover, the lean-back offerings of directly licensed services are significant competitors to statutory services. Nearly of UMG's plays on [ ], for example, are programmed streams rather than on-demand plays. Hr'g Ex. SX-25 ¶ 11 (Harrison WRT).

Similarly, there has been "massive growth on the playlist side" of Spotify's business, with approximately [redacted] of total listening of [redacted] repertoire occurring through playlists created by Spotify or third parties. Hr'g Ex. SX-27 at 16 (Kooker WRT); Hr'g Tr. 6599:22-6600:3 (May 29, 2015) (Kooker).

50. Pandora also sees these lean-back offerings as a competitive threat. According to [redacted] Pandora considers [redacted] and [redacted] to be [redacted] to its radio service. Hr'g Ex. SX -63 at 11.

51. In sum, in today's streaming market, services cannot be categorized as either "interactive" or "non-interactive": so-called "interactive" services have lean-back listening options, and nominally "non-interactive" services have lean-forward capabilities. Hr'g Tr. 1182:23-1183:7 (Apr. 30, 2015) (Harrison). As a result of their near-identical range of offerings, these services look very much the same in the eyes of consumers, who do not meaningfully differentiate between statutory and non-statutory services. *Id.* at 1179:14-25 (Apr. 30, 2015) (Harrison). The Services' attempt to frame on-demand listening as "the core of [non-statutory services'] business model" is therefore inconsistent with market realities. PAN PFOF ¶¶ 307-308. [redacted]. Hr'g Ex. SX-1719 at 4 ([redacted] In today's streaming market, competitive services do not exclusively offer pure on-demand listening—[redacted]]." Hr'g Tr. 2542:3-2543:2 (May 7, 2015) (Wilcox); Hr'g Tr.3450:11-3452:3 (May 13, 2015) (Herring). Directly licensed services simply cannot afford to be so limited, because the music consumer is "both a lean-forward and a lean-

back type of listener." Hr'g Tr. 6570:18-23 (May 29, 2015) (Kooker); Hr'g Ex. SX-27 at 3 (Kooker WRT).

iii. Statutory Services Are Offering Increased Control Over Music Selection

52. In much the same way that they incorrectly brand directly licensed services as "on-demand," the Services paint an incomplete picture of statutory services when they suggest they merely "offer[] a 'lean-back,' radio-style listening experience" over which users "have no control." PAN PFOF ¶ 281. SoundExchange set forth at length in its Proposed Findings the evidence that shows that statutory services have been exploring the bounds of functionality under the statutory license to satisfy listeners' demand for lean-forward options. SX PFOF ¶¶ 271-290.

53. Pandora insists, however, that it is not doing anything to converge with non-statutory services, claiming that "the major functionality of Pandora has not changed dramatically at all." PAN PFOF ¶ 292. Though it may be happening [ ] rather than "dramatically" (Hr'g Ex. SX-269 at 183), the evidence shows that Pandora has made a concerted effort to [ ] *Id.* at 43. Because all streaming services are competing for the very same base of consumers to whom it is inevitable that statutory services will strive to satisfy the full range of this demand, particularly given that their directly licensed competitors are becoming one-stop-shopping destinations.

54. One illustration of this phenomenon is [redacted]

[redacted]:

RESTRICTED DOCUMENT

[redacted]

55. In response to this internal research, Pandora has put [redacted]

[redacted] Hr'g SX-1678 at 14-15. While it is unclear exactly how far Pandora's various [redacted]

[redacted], we know that its efforts have already started "shrinking the difference that on-demand functionality makes to consumers." Hr'g Ex. SX-21 ¶ 35 (Wheeler WDT).

56. Pandora resists this idea in its proposed findings, arguing that none of its features enhance "users' ability to select a particular song for listening at the time he or she wants to listen to it." PAN PFOF ¶ 294. Although it is undeniably true that statutory services are precluded from allowing their users to literally select songs on-demand, consumers cannot necessarily tell the difference. In July 2014, for example, [redacted] Hr'g Ex. SX-269 at 24. [redacted] Hr'g Ex. SX-1679 at 18. [redacted] *Id.* at 20. As Pandora recognizes, it is creating this [redacted] that is important for capturing consumers. Hr'g SX-269 at 42-43.

iv. Both Directly Licensed And Statutory Services Offer Free Options

57. The Services also incorrectly characterize directly licensed services as subscription-only services that exist exclusively for a small segment of consumers who are willing to spend money on music. *See, e.g.*, PAN PFOF ¶¶ 310-313. In fact, the majority of listening on directly licensed services occurs on the services' *free* tiers. Hr'g Tr. 404:5-18 (Apr. 28, 2015) (Kooker) [redacted]; Hr'g Tr. 1153:19-25 (Apr. 30, 2015) (Harrison); Hr'g Ex. SX-48.

58. The Services' fail to account for the fact that [redacted] The Services' argument that "Pandora is not satiating users who otherwise would be paying to subscribe to Spotify" therefore misses a crucial step—consumers overwhelmingly begin as free users on directly licensed services. PAN PFOF ¶ 323.

59. Once users are drawn in to directly licensed services' freemium funnels, they become far easier to convert to paying subscribers. [redacted] Because directly licensed services' free tiers enable upsell opportunities and are essentially the services' "subscriber acquisition mechanism," they represent an important value proposition. Hr'g Tr. 1046:2-12 (Apr. 30, 2015) (Harrison). Even if only a relatively small proportion of the free listeners ultimately become subscribers, the directly licensed free tier still creates several orders of magnitude more value for the record companies than do statutory services, which "make little or no effort to convert free listeners to paying subscribers." Hr'g Ex. SX-10 at 8 (Harrison WDT) (testifying that directly licensed services pay effective rates of between [redacted] per play, depending on functionality); Hr'g Ex. SX-12 at 15, 18 (Kooker WDT) (contrasting Pandora's annual ARPU of $6.42 with directly licensed services' annual ARPU of $119.88); Hr'g Ex. SX-59 (showing a simple average

effective per play rate of [ ] for directly licensed services between July 2013 and May 2014). By ignoring directly licensed services' free listeners, the Services miss a crucial element of the competition and convergence in the market.

v. Directly Licensed Services And Statutory Services Compete For The Same Listeners

60. In their proposed findings, the Services repeatedly suggest that the only potential source of evidence to corroborate the convergence "theory" is Prof. Rubinfeld. IHM PFOF ¶ 303; PAN PFOF ¶¶ 274, 286, 290-294. But Prof. Rubinfeld is by no means the sole—or even the primary—source for evidence of convergence. The best evidence of convergence comes directly from the market participants—the record companies and the Services themselves.

61. As Prof. Shapiro rightfully observed, the views expressed in "the normal-course-of-business documents that people are using to make decisions" are "the best stuff" and should be given more weight than the "[s]tuff that's created for litigation." Hr'g Tr. 2717:10-25 (May 8, 2015) (Shapiro); Hr'g Tr. 4911:20-25 (May 20, 2015) (Shapiro). Here, these course-of-business documents squarely contradict the Services' claims that they do not compete for listeners against directly licensed services that offer on-demand functionality. SX PFOF ¶¶ 296-301.

62. For example, Sirius XM claims that its streaming service "does not directly compete" with those services included in Prof. Rubinfeld's benchmark analysis. SXM PFOF ¶ 14. It goes so far as to suggest that Spotify and "gardening" are similarly situated vis-à-vis Sirius XM's online streaming service. *Id.* ¶ 15. But this untenable argument has no corroboration in any of Sirius XM's business documents. Those documents never consider the competitive threat posed by "television and movie viewing, book reading, gardening, and quite reflection." *Id.* They are instead singularly focused on [

[redacted]

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[redacted]

Hr'g Ex. SX-1759 at 15.

63. Similarly, iHeartMedia suggests in this proceeding that it is unaware of any evidence that consumers might substitute between statutory and non-statutory services. IHM PFOF ¶ 303. [redacted]

[redacted]

[redacted]:

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[redacted]

[redacted].

64. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]:

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Hr'g Ex. SX-269 at 10, 26.

65. According to Pandora's internal research, [redacted], which suggests that the competition will only continue to intensify over the next rate period. Hr'g Ex. SX-1678 at 12; Hr'g Ex. SX-1680 at 5.

[redacted]:

[redacted]

Hr'g Ex. SX-1678 at 13.

66. In its proposed findings, Pandora also claims that directly licensed services like Spotify are complementary to the Pandora listening experience and that, to the extent there is any competition, it only occurs "at the margin." PAN PFOF ¶¶ 330-339. But this litigation position is [redacted] Hr'g Ex. SX-1678 at 8; Hr'g Tr. 4931:6-12 (May 20, 2015) (Shapiro). Indeed, Pandora's own expert, Prof. Shapiro, conceded that Pandora, Rhapsody, Spotify, and iHeart all compete for listeners. Hr'g Tr. 4906:10-12 (May 20, 2015) (Shapiro) ("[Y]es they all compete in the downstream market. No quibble about that.").

67. [redacted] Hr'g Ex. SX-1652.

68. And Pandora's competition with the likes of Spotify, iTunes Radio, Rdio, and Google Play is not limited to competition for listeners. [redacted]

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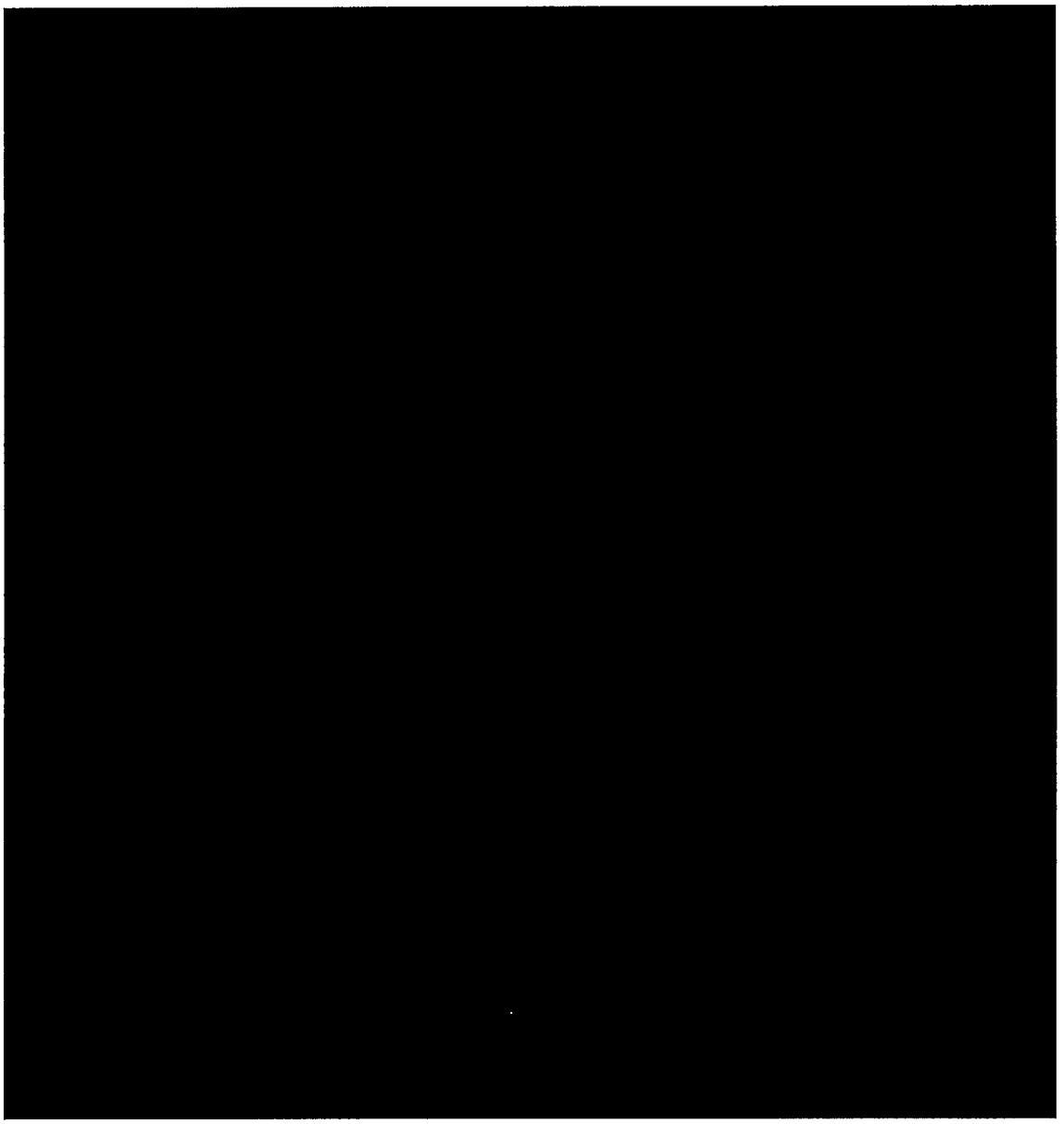

Source: Hr'g Ex. SX-269 at 121.

b. Competition And Convergence Occurring In Downstream Consumer Market Affects Upstream Licensing

69. The increasing competition and convergence between statutory and non-statutory services is critical to this proceeding because of the link between the downstream consumer market and the upstream licensing market.

70. As Mr. Harrison testified, for example, Universal [redacted] Hr'g Tr. 975:2-5, 1038:7-13 (Apr. 30, 2015) (Harrison). [redacted] Hr'g Tr. 975: 2-14, 976:2-21 (Apr. 30, 2015) (Harrison); *see also id.* 979:3-13; 1004:2-15 [redacted]

71. Prof. Shapiro likewise recognized that the downstream and upstream markets are inextricably intertwined. Hr'g Tr. 2625:8-14 (May 8, 2015) (Shapiro). The upstream licensing market "feeds into the downstream market because Spotify and Rhapsody pay these royalties, and that affects their cost structure. And then they, of course, then, compete downstream through their services and their subscription rates for listeners." *Id.*; Hr'g Tr. 5049:10-25 (May 20, 2015) (Shapiro) (agreeing that downstream competition with piracy "has affected the price in the upstream licensing market").

72. Similarly, Pandora's [redacted]

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[redacted]

73. Indeed, as this document also notes, Pandora is concerned that its ["[redacted]"] Hr'g Ex. SX-269 at 64. (emphasis added).

74. This connection between the downstream and upstream markets can also be seen in the steady decline in rates for directly negotiated services. Hr'g Ex. SX-17 ¶ 140 (Rubinfeld Corr. WDT). As competition between statutory and non-statutory services has intensified,

record companies have had to lower their negotiated rates to enable their directly licensed partners to effectively compete with services that benefit from much lower statutory rates. *Id.*; Hr'g Ex. SX-10 ¶ 18 (Harrison Corr. WDT); Hr'g Tr. 1045:20-1050:7 (Apr. 30, 2015) (Harrison) [redacted]; Hr'g Tr. 2973:8-19 (May 11, 2015) (Katz).

c. Pandora's Theory Of Separate Upstream Markets Has No Economic Or Empirical Basis: Pandora's "Upstream Markets" Are Distinct Only Because Of The Statutory License

75. Pandora argues that convergence is a "'detour' and 'distraction' from the 'benchmarking exercise,'" and claims that "'[c]onvergence is entirely about competition for listeners in the downstream market—it tells us nothing about the comparability of the two distinct upstream markets at issue.'" PAN PFOF ¶ 276 (quoting Hr'g Ex. PAN 5023 at 13 (Shapiro WRT)).

76. Pandora rests this theory on Prof. Shapiro's Figure 5. PAN PFOF ¶ 277. But at the hearing Prof. Shapiro acknowledged that the sole basis for the dividing line in Figure 5 that separates the "two separate and distinct upstream markets" is the statutory license. Hr'g Tr. 4906:13-4909:6 (May 20, 2015) (Shapiro). The "separate and distinct upstream markets" in Prof. Shapiro's Figure 5, therefore, do not represent separate markets in any economic sense; indeed, Prof. Shapiro did not undertake any market-definition "analysis of the type that an economist normally would." SX PFOF ¶ 303; Hr'g Ex. PAN 5023 at 10 (Shapiro WRT).

77. Instead, Prof. Shapiro himself testified that in a world without the statutory license, there would be an "interrelation" between a record company's negotiation with a streaming service and that streaming service's competitive landscape downstream:

> [F]rom the record companies' point of view, I suppose the record company sitting down with one customer, the opportunity cost of licensing to that customer is going to depend on the rate set to other customers and the diversion between the target customer and other customer.

Hr'g Tr. 4911:1-6 (May 20, 2015) (Shapiro). Prof. Shapiro also recognized that this interrelationship means that competition for listeners in the downstream market would have a direct impact on the outcome of license negotiations if the statutory license did not exist:

Hr'g Tr. 4947:15-4949:7 (May 20, 2015) (Shapiro); *see also id.* 4935:3-6.

78. Pandora also broadly asserts, without elaboration, that "'the convergence theory does not imply that [the services] are similar buyers in the upstream market.'" PAN PFOF ¶ 278. But Pandora fails to identify any differences between statutory and non-statutory services that would make them distinct categories of licensing buyers if the statutory license no longer

existed.[3] Nothing suggests that willing sellers' negotiating behavior with statutory services would differ as compared to their negotiating behavior with directly licensed services in a world without the statutory license.

79. At bottom, Pandora's vague, unsupported claim that downstream competition and convergence is "irrelevant" to upstream licensing defies economic logic and common sense. PAN PFOF ¶ 280. The "willing sellers" in the licensing market have a keen interest in the services' convergence and downstream competition for listeners. And the reason is simple: a consumer's decision to listen to Pandora rather than Spotify has a direct—and sizable—effect on record companies' bottom line. Hr'g Tr. 969:20-970:16 (Apr. 30, 2015) (Harrison).

80. Directly licensed services like Spotify not only provide record companies with significantly higher guaranteed minimum per-play compensation than do Pandora or iHeartMedia under the statutory license,[4] but they also encourage consumers to open their wallets, which is critical for the "overall health" of the industry. Hr'g Tr. 401:7-22 (Apr. 28, 2015) (Kooker); Hr'g Tr. 969:20-970:16 (Apr. 30, 2015) (Harrison).

81. Labels employ a variety of mechanisms to maximize directly licensed services' conversion of users to paid tiers. Hr'g Tr. 401:19-403:10 (Apr. 28, 2015) (Kooker).

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[3] There is no reason to suspect that either of the purported differences that Pandora points to elsewhere in their proposed findings—ability to steer and promotional effects—would place statutory services in a distinct upstream licensing market. With respect to the former, the evidence shows that, absent the statutory license, it is implausible that statutory services could profitably use steering to their advantage any more so than could non-statutory services. SX PFOF ¶¶ 730-747; Hr'g Ex. SX-19 at 34-35 (Talley WRT); Hr'g Tr. 1020:1-22, 1024:12-1026:14 (Apr. 30, 2015) (Harrison). Similarly, the Services have identified no compelling evidence that there is any meaningful difference in the services' relative promotional effects. SX PFOF ¶¶ 1141-1161; Section II.B.3, *infra*.

[4] [redacted]r'g Ex. SX-59 (in 2013-2014, directly licensed services' guaranteed to pay record companies a simple average of [redacted] per play)

82. [redacted]. For example:

- [redacted]
- [redacted]
- [redacted]

- [redacted]:

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[redacted]

Source: Hr'g Ex. SX-80 [redacted].

83. [redacted]

[redacted]

84. [redacted]

]. Under these provisions, [redacted]

H'rg Tr. 1054:7-12 (Apr. 30, 2015) (Harrison); Hr'g Ex. SX-10 ¶ 13 (Harrison Corr. WDT); Hr'g Ex. SX-37 at 86

[redacted]

85. As a result of these conversion incentives, non-statutory services generate far more ARPU than do statutory services. Hr'g Ex. SX-10 ¶¶ 14-15 (Harrison Corr. WDT); Hr'g Ex. SX-12 at 15, 18 (Kooker WDT). Because record companies share in the revenue earned by their directly licensed partners, the higher ARPU translates to substantially higher total effective compensation per play for the record companies. Hr'g Ex. SX-10 ¶¶ 14-15 (Harrison WDT); Hr'g Ex. SX-59.

86. To the extent statutory services are competing with—and taking users from—these higher ARPU streaming services, it would negatively affect record companies' revenues. For this reason, record companies "cannot afford to be platform agnostic." Hr'g Ex. SX-21 ¶ 30

(Wheeler WDT); Hr'g Tr. 2404:20-23 (May 7, 2015) (Wilcox) [redacted]

Hr'g Tr. 1057:1-7 (Apr. 30, 2015) (Harrison); *accord* Hr'g Tr. 2530:20-2531:3 (May 7, 2015) (Wilcox) [redacted]

87. Indeed, Pandora's internal documents show that it recognizes that [redacted] "] Hr'g Ex. SX-269 at 64. (emphasis added).

88. In the current market, however, the deck is stacked against labels' directly licensed partners. Competing against statutory services to attract users into their freemium funnels is an uphill battle because statutory services can freely run "very few ads or no ads in the case of . . . iHeart" while offering a highly customized, lean-forward listening experience and (in the case of Pandora) paying significantly below-market royalties. Hr'g Tr. 376:15-377:3, 403:23-404:4 (Apr. 28, 2015) (Kooker) [redacted]); Hr'g Tr. 2407:19-24 (May 7, 2015) (Wilcox) [redacted]

[redacted]).

89. Unconstrained by the statutory license, labels would not willingly accept these disparities that allow statutory services to gain market share at the expense of their directly licensed partners. Hr'g Tr. 1113:14-19 (Apr. 30, 2015) (Harrison). In the hypothetical market, statutory services would compete with other streaming services in the upstream market for licenses in the very same way they currently compete downstream for listeners.

90. Rather than willingly permit Pandora to use royalty savings and low ad loads to siphon users from the likes of Spotify, Rdio, Rhapsody, and Apple, labels would negotiate direct licenses with Pandora or iHeart to put them on more equal footing with their competitors by either: (i) negotiating revenue shares along with conversion incentives or other mechanisms to maximize their ARPU; or (ii) requiring a higher minimum per-play rate where there is either no revenue share prong or mechanism to maximize ARPU. *See, e.g.*, Hr'g Ex. SX-25 ¶ 31 (Harrison WRT) (testifying that in the hypothetical market if a "webcaster chose not to convert users or agree to [] a conversion funnel, we would need to be compensated with higher rates for the free tier"); Hr'g Tr. 375:16-21 (Apr. 28, 2015) (Kooker) (moving listeners from lower ARPU offerings to higher ARPU offerings is "critical" goal for Sony); Hr'g Tr. 2403:15-2404:8 (May 7, 2015) (Wilcox) [redacted]).

91. It would be economically irrational for labels to treat statutory services any differently, and the Services have offered no sound evidence to suggest they would. Hr'g Ex. SX-21 ¶ 30 (Wheeler WDT) ("[W]hen services that compete for consumer consumption with lower revenues per-stream or per-user are offered rates below those of other competitors," record

companies are only "subsidizing [their] own demise."). Instead, record company witnesses have testified that they "would take the same approach" with statutory services like Pandora "and the structure of the deal would generally be the same." Hr'g Tr. 1080:17-24 (Apr. 30, 2015) (Harrison); Hr'g Ex. SX-21 ¶ 36 (Wheeler WDT) ("I would expect that a negotiating framework for webcasting would largely approximate the on-demand service framework."). Record companies simply could not afford to "allow certain services to gain a competitive advantage over other platforms that are more willing to offer a higher value per consumption." Hr'g Ex. SX-21 ¶ 30 (Wheeler WDT); Hr'g Tr. 2545:10-18 (May 7, 2015) (Wilcox) ([redacted]).

92. To the extent any statutory service was unwilling to agree to these conversion incentives and upsell opportunities, in the hypothetical market a label could simply choose to not license to the service at all and instead rely on its many directly licensed services to reach the same lean-back listeners at market rates. Aaron Harrison put it in no uncertain terms: "Universal would never do a deal with Pandora at the rates it currently pays." Hr'g Ex. SX-10 ¶ 16 (Harrison Corr. WDT).

93. In sum, while Pandora might prefer to operate in a "separate and distinct" licensing market if it could no longer rely on the statutory license, no economically rational record company would abide by the artificial dividing line in Prof. Shapiro's Figure 5 and treat Pandora differently than it treats Pandora's [redacted] competitors. Pandora's suggestion that willing sellers would act against their own self-interest and grant preferential treatment to statutory services that draw consumers from services that generate more revenue defies logic and common-sense. Hr'g Tr. 969:20-970:16 (Apr. 30, 2015) (Harrison).

3. The Evidence Clearly Shows That Statutory Services Are Substitutional Because They Interfere With And Substitute For The

"Other Stream[] Of Revenue" That Will Be Most Critical Over The Next Rate Term—Higher-ARPU Services; Statutory Services Are Not *More* Promotional To The Record Industry's Declining Source Of Revenue—Sales Of Sound Recording Copies

94. Section 114(f)(2)(B)(i) instructs the Judges to base their determination of the rates on "whether use of the [statutory] service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings."[5] 17 U.S.C. § 114(f)(2)(B)(i). The Services' arguments regarding substitution and promotion are wrong in two critical respects. First, the Services ignore or downplay the uncontroverted and overwhelming evidence that the use of statutory webcasting services interferes with and substitutes for higher-ARPU offerings on directly licensed services. Revenue from these competing services will be the dominant "other stream[] of revenue" that copyright owners will depend on over the 2016-2020 rate term, and this interference/substitution therefore is critical to assessing the appropriate rate for this term. Second, the Services argue that statutory services promote record sales, and that they are particularly promotional relative to non-statutory services. But record sales are declining and will continue to decline over the coming rate term, and the evidence does not show that statutory services have any measurably more promotional effect as compared to directly licensed services. Hence, the Services focus on the wrong "other stream[] of revenue," and their arguments even on that score are not supported by the evidence.

[5] Section 114(f)(2)(B) also requires the Judges to base their decision on "the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk." 17 U.S.C. § 114(f)(2)(B)(ii). SoundExchange discusses this factor thoroughly in Section IV of its Proposed Findings of Fact.

95. The "net" promotion/substitution inquiry thus is clear and straightforward. Statutory services interfere with and have a net negative impact on revenues from directly licensed services. Statutory services are no better than neutral in their impact on sales of physical and digital copies of sound recordings. Thus, the overall impact of statutory webcasting is negative on copyright owners' other streams of revenue. Under § 114(f)(2)(B)(i), the rates for the 2016-2020 rate term must account for this substitution/interference with other streams of revenue to the industry.

96. Subsection II.B.3.*a* first addresses the net substitutional effect that statutory services have on (and interference with) the recorded music industry's currently fastest-gaining other stream of revenue—higher-ARPU, directly licensed streaming services, such as Spotify, Rhapsody, Apple (Beats, Apple Music, and iTunes Music), and others. Revenue from directly licensed subscription services will be the most important revenue stream to the industry for the 2016-2020 rate term and the Services pay it little attention. NAB, for one, does not even mention (let alone refute) SoundExchange's evidence that statutory services including simulcasters interfere with revenue from directly licensed streaming services in its discussion of promotion/substitution. *See* NAB PFOF § III.C. The Services cannot truly dispute that they directly compete with and steal users from these higher-ARPU services that (1) aim to convert users to paid subscriptions at the $9.99 price level ([ ]), which provide the highest level of compensation to the recorded music industry of any streaming service offering; and (2) typically pay more in royalties to record labels even on their free-to-the-consumer offerings than do the free statutory services. The Services' averments to webcasting services being "complements" is wholly unpersuasive and without any evidence that webcasters actually *promote* or *enhance* these revenue streams.

Pandora cannot (and does not) seriously argue here that it actively encourages users to listen to music on Spotify rather than Pandora.

97. Subsection II.B.3.*a* further shows that the Services are wrong to focus on substitution/promotion of physical and digital sales, and why the Services' evidence cannot prove that they promote purchasing. The undisputed evidence is that revenues to the recorded music industry have continued to decline as webcasting has grown in popularity and usage. The Services' cannot and do not dispute this fact. They instead argue that consumers would be purchasing *even fewer* CDs and digital downloads were it not for webcasting services. But, the Services offer no evidence whatsoever that this is the case and it is belied by the clear market trends. Simulcasters offer no empirical evidence at all that they promote sales, satisfied to draw comparisons to terrestrial radio and rest on the now dated (and false) belief that simulcasters are exactly the same as terrestrial radio. In any event, record companies—those individuals who "willingly sell" with the promotional or substitutional impact of a service in mind—view these services as substitutional, not promotional, for download sales and would seek higher licensing rates accordingly.

98. Subsection II.B.3.*b* addresses the Services' failure to show that the promotional/substitutional effects on sales of sound recording copies differ between statutory and non-statutory services. iHeart continues to rely on the proven-unreliable survey of Dr. Todd Kendall. Notably none of the other Services cite to Dr. Kendall in their Proposed Findings at all, and for good reason. Much less provide helpful analysis of the relationship between listening and purchasing, the results of Dr. Kendall's study turn on a quirk in the method by which [redacted] measures listening duration. In a last ditch effort to point to *some* empirical evidence, the Services also claim that SoundExchange's expert, Dr. Blackburn's analysis

supports their argument that statutory and non-statutory have meaningfully different effects on consumers' purchasing behavior. This is not so. Aside from being wrong as a matter of interpreting the study, iHeart and NAB's claim in this regard lacks credibility because iHeart *withdrew* the same study when Prof. Danaher offered these results.

99. Subsection II.B.3.*c* concludes by acknowledging the Services' newfound argument that diversionary promotion, rather than expansionary promotion is what matters for the § 114(f)(2)(B)(i) inquiry. This is wrong as a matter of statutory interpretation and, factually irrelevant because it merely reiterates the Services' arguments regarding steering, bringing nothing new to the discussion of what a willing seller would do when faced with the non-existent proposition that a service would steer toward or away from that labels' sound recordings. The hypothetical scenario the Services rely upon does not exist absent the statutory license.

*a. Statutory services have a net substitutional effect on **other** streams of revenue to the recorded music industry*

i. The evidence proves undeniably that statutory services interfere with directly licensed services

100. The Services would have the Judges believe that statutory and non-statutory services have fundamentally *different* offerings and occupy *different* markets; thus, they cannot possibly be substitutes for one another. *See* PAN PFOF §§ IV.C., I.D (¶¶ 20-27). The record proves these assertions undeniably false. The facts show that statutory and non-statutory services have some of the *same* "customized" or "curated" streaming offerings and occupy the *same* market of digital music streaming services (as consumer products and "willing buyers"). As a result, statutory services substitute for and interfere with the revenue that copyright owners earn from non-statutory streaming services. This interference is not trivial—it impacts the revenue stream (revenues from directly licensed subscription services) that undisputedly will be of greater-and-greater importance in the record companies' overall mix of revenue during the

2016-2020 rate term. *See* Section II.B.2 *supra*; *see also* SX PFOF § V.B (¶¶ 226-56) (discussing the shift from ownership to access). Statutory services substitute for (and interfere with the revenue derived from) non-statutory services for at least four reasons.

101. As a threshold matter, not a single service-side participant makes (nor could they make) the argument that statutory services actively promote paid subscriptions to directly licensed services. It is not in the Services' interest to encourage users to listen to competing services offering the same customized and curated programming. Rather, the Services' incentives are actually aligned with the opposite goal—retain consumers and listening time. *See* Hr'g Ex. SX-21 at 19 (Wheeler WDT) (describing economic incentives for webcasters to seek to retain consumers).

102. *First*, these services have the same consumer offerings—both offer "customized" and "curated" streaming in some form or another:

- ***Pandora*** offers a "customized or personalized" radio-like listening experience as well as "genre stations" which "are pre-programmed collections of songs . . . populated with songs that are hand-selected by Pandora's music curation team." Hr'g Ex. PAN 5002 ¶¶ 8, 16 (Fleming-Wood WDT).

- ***iHeartRadio*** offers both "a digital simulcast radio service" and a "custom radio product, which builds playlists for listeners based on the songs and artists they like." IHM PFOF ¶ 12 (citing Hr'g Ex. IHM 3222 ¶ 9 (Pittman WDT)).

- ***SiriusXM Internet Radio*** offers non-customized curated stations and "My Sirius XM" which "allows subscribers to slightly personalize a select group of music and comedy channels from the satellite service, to adjust for characteristics like library depth, familiarity, and music style." SXM PFOF ¶ 24 (citing Hr'g Ex. SXM 6000 ¶ 28(Frear WDT).

- ***Nokia*** is a directly licensed service that offers customized and programmed webcasting. Hr'g Ex. SX-10 ¶ 51 (Harrison Corr. WDT).

- ***Spotify*** offers customized radio and programmed playlists. Hr'g Ex. SX-27 at 15 (Kooker WRT) ("Spotify added a 'Radio' feature that approximates the experience offered by statutory webcasters offering custom radio. It even includes 'thumbs' like Pandora.").

- ***Beats*** offers The Sentence, which curates *non-customized*, streaming on a free-to-the-consumer basis. Hr'g Ex. SX-36 at 12 [( )]; *see also* Hr'g Ex. SX-29 ¶ 180 (Rubinfeld Corr. WRT). As Mr. Kooker noted, Beats even offers curated playlist by Broadcasters such as Hot 97 and KROQ. Hr'g Ex. SX-27 at 17 (Kooker WRT).

- ***TuneIn*** offers a selection of numerous simulcast services including numerous NAB member stations. Hr'g Exs. NAB 4002 ¶ 14 (Dimick WDT); NAB 4009 ¶ 9 (Dimick WRT).

103. The purportedly non-interactive statutory services likewise offer "on-demand" streaming. ***Pandora*** offers, in addition to is customized radio offering, Pandora Premieres which "allows for on-demand selection of certain predetermined albums." Hr'g Ex. PAN 5002 ¶ 30 (Fleming-Wood WDT). Pandora documents further discuss listeners' [.] Hr'g Ex. SX 268 at 9 ([ ]). Pandora has further [ ]. *See* SX 263 at 10.

104. Even ***SiriusXM Internet Radio*** offers "SiriusXM On Demand" which "allows subscribers to choose favorite episodes from a catalog of thousands of hours of Sirius XM shows, specials, series, live events, and more" at least 15% of which is on-demand listening to music. SXM PFOF ¶¶ 23, 25 (citing Hr'g Ex. SXM 6000 ¶ 28 (Frear WDT); Hr'g Tr. 5421:19-22 (May 22, 2015) (Frear)).

105. The streaming and record industries recognize these overlapping offerings. As Mr. Fleming-Wood, acknowledged "most" interactive services have "what they would call the radio function," that combines both "lean[-]back" offerings and higher control functions. Hr'g Tr. 6142:19-6143:13 (May 27, 2015) (Fleming-Wood). As Mr. Harrison explained when describing the same documents that Pandora cites as proof that so-called "lean-back" services are distinct from "lean-forward" services—these services actually offer both types of listening options:

Hr'g Tr. 1182:23-1183:7 (Apr. 30, 2015) (Harrison) (Mr. Harrison was referencing Hr'g Exs. PAN 5046 at 8 and PAN 5048 at 44).

106. *Second*, these services compete head-to-head for users and listening time. The Services' own internal documents demonstrate that they compete with directly licensed services (such as Spotify, Google Play, Apple and numerous others) actively aiming to steal away users and listening time from these higher revenue generating services. These internal company documents (which Prof. Shapiro describes as "the best stuff" (Hr'g Tr. 2717:10-25 (May 8, 2015))) are described at length in SoundExchange's Proposed Findings of Facts, Sections V.C and XIII.C.1 (¶¶ 1105-11), and above in Section II.B.2, and will not be repeated in full here. As a general matter, these documents show Pandora, iHeart, and SiriusXM [ ] as well as [ ]. *See, e.g.*, Hr'g Exs. SX. SX-1189 (iHeart), SX-1190 (iHeart), SX-266 (Pandora), SX-263 (Pandora), SX-1652 (Pandora), SX-2244 (Pandora); Hr'g Tr. 5413:14-24 (May 22, 2015) (Frear) (describing internal documents [ ]); Hr'g Tr. 3490:10-3491:4 (May 13, 2015) (Herring) (describing internal documents).

107. Survey expert, Ms. Sarah Butler, Vice President at NERA Economic Consulting, reviewed a substantial number of internal and publicly available marketing and survey work and

found "evidence that statutory webcasting services, particularly Pandora and iHeartRadio, compete with directly-licensed services, especially services offering on-demand functionality, like Spotify." Hr'g Ex. SX-5 ¶ 11 (Butler WRT). Among the documents she reviewed, Ms. Butler found that "[i]n its own analyses, Pandora [ ]." *Id.* ¶ 27.

108. This competition is true for both custom services *and* simulcast services. As Mr. Littlejohn admitted at the hearing [ ]. Hr'g Tr. 3659:14-21 (May 13, 2015) (Littlejohn). Mr. Littlejohn went on to explain:

[ ]

Id. at 3659:17-3660:2. Services offering simulcast streaming—particularly aggregators like iHeartRadio and TuneIn have developed features that put their product offerings in direct competition with customized and interactive streaming services. *See* Section VI, *infra.* For example, TuneIn and iHeartRadio permit searching that displays not only a list of stations, but also the songs that have just started playing on those stations, allowing the user to pick the particular song from that list and join instream. Hr'g Tr. 5841:11-14 (May 26, 2015) (Dimick). Likewise, a user on TuneIn can pause and record songs. *Id.* at 5850:9-5851:7. iHeart further

negotiated a [ ]. Hr'g. Ex SX-34 at 1 (emphasis added).

109. iHeart and NAB argue that simulcasting is *not* converging and is *not* competing with other streaming services based on the lack of empirical evidence regarding how many consumers actually use these features. *See* IHM PFOF ¶ 309. This argument is a red herring. iHeart and NAB must concede that only one logical business reason exists to offer these features on a simulcast service, and that is to make those services more competitive with the other digital streaming services that offer similar functionality. As Mr. Dimick put it: "one of the things that we do is try to skate to where the puck is going to be." Hr'g Tr. 5836:17-19 (May 26, 2015) (Dimick). In other words, simulcasters are aiming to get ahead of the market to attract users and make their streaming more competitive.

110. Those users who are satisfied with their experience on Pandora, iHeartRadio, or other webcasters have less incentive to pay for a higher-ARPU subscription service. Hr'g Ex. SX-12 at 18-19 (Kooker WDT) ("if someone is listening to 22.5 hours per month on Pandora—and that is just the average—it decreases the likelihood they will have the additional time, interest or inclination to consider paying for music on higher-ARPU directly licensed subscription services"). In contrast, as an initial matter, the recorded music industry would rather consumers enter the "freemium" funnel of directly licensed services [ ] that encourage the service to convert free users to paying subscribers; and (2) as matter of average ARPU per service [ ]. *See, e.g.*, Hr'g Ex. SX-36 at 9 [(

[redacted]. In the following [redacted].

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[redacted]

Hr'g Ex. IHM 3116 at 9 (highlighting added).

111. Survey evidence further confirms that statutory services substitute for higher-ARPU directly licensed services. Ms. Butler surveyed consumers precisely to determine "for which other types of music listening iHeartRadio and Pandora substitute in the opinion of

consumers." Hr'g Ex. SX-5 ¶ 2 (Butler WRT).[6] As explained in SoundExchange's Proposed Findings of Fact XIII.C.4.a (¶¶ 1127-31), the substitution survey that Ms. Butler conducted found that the most likely substitutes for Pandora and iHeartRadio are directly licensed streaming services. *See* Hr'g Ex. SX-5 ¶ 12 (Butler WRT) (51.4% of current Pandora users and 28% of current iHeartRadio users would otherwise listen to directly licensed services as compared to only 9% of Pandora users and 12.1% of iHeartRadio users who would otherwise listen to AM/FM radio)

112. The Services' criticisms of Ms. Butler's survey do nothing to defeat the clear and obvious trend that consumers' responses reveal—consumers view directly licensed streaming services, *not terrestrial radio* as the most likely substitutes for statutory services. Neither NAB nor Pandora address Ms. Butler's survey or her report at all in their Proposed Findings. iHeart levies two unpersuasive critiques[7]: (1) Ms. Butler did not conduct a pre-test and (2) she did not survey consumers regarding their willingness to pay (which emphatically was not her aim). IHM PFOF ¶¶ 304-306. Neither of these criticisms impugn her ultimate conclusions.

113. Taking iHeart's criticisms in turn, first, iHeart is correct that Ms. Butler did not conduct a formal pre-test, however, as she explained, she "analyzed or reviewed the results as they came in to make sure that there weren't any difficulties in taking the survey." Hr'g Tr. 6782:21-24 (May 29, 2015) (Butler). With such a straight-forward survey, and other quality

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[6] Contrary to iHeart's cavalier claims that "SoundExchange has not offered any empirical data showing that consumers are using statutory services as a substitute for interactive services," IHM PFOF ¶ 303, Ms. Butler's survey demonstrates that consumers indeed view statutory and non-statutory services as competitors and substitutes, Hr'g Ex. SX-5 (Butler WRT).

[7] In passing, iHeart faults the survey was from a non-probability sample and therefore confidence intervals are inappropriate. This critique, if it is one, would likewise hold for Dr. Hanssens who also conducted a survey using an internet panel. iHeart further objected to Ms. Butler's testimony regarding the confidence intervals that she ran. Hr'g Tr. 6780:13-6781:13 (May 29, 2015) (Butler).

checks, a formal pre-test was not necessary. *See* Hr'g Ex. SX-5 ¶ 34 (Butler WRT) (discussing quality control measures). iHeart's quotations from Dr. McFadden and Dr. Hauser regarding a pre-test relating to a *conjoint survey* do not change this and do not relate to the sort of survey conducted by Ms. Butler. *See* IHM PFOF ¶ 305. Likewise, iHeart suggests that the results were somehow distorted because the survey lists Spotify (free/paid) and Pandora (free/paid), as well as listing "Vevo or YouTube (for music)" as compared to breaking each separate offering out. *See* IHM PFOF ¶ 305. iHeart gives no reason to think that the results would be meaningfully different had these questions been worded differently. To the contrary, the results are consistent with the market and suggest people understood the survey.

114. iHeart's second purported critique is that Ms. Butler did not survey users regarding their willingness to pay for a subscription is not a critique at all because whether or not users would be willing to pay for a subscription is immaterial to her ultimate conclusion regarding substitution. This critique weighs just as heavily against iHeart's own evidence for why Spotify is *not* a substitute for Pandora, because iHeart's "listening caps [experiment]" is *not* based on willingness to pay but rather user migration of the 4% of high-intensity Pandora users impacted by its 40-hour per month listening hour cap. IHM PFOF ¶¶ 300, 308 (citing Fischel/Lichtman WRT ¶¶ 16-20, 48). In any event, the very point SoundExchange makes regarding substitution between statutory and non-statutory services here—that even users of free directly licensed services ultimately be more valuable to the record labels if the "funnel" encourages them to subscribe and because as an average matter, the free offerings of directly licensed services may be higher-ARPU than free Pandora—is independent of that users reported willingness to pay.

115. To the extent willingness to pay evidence is relevant to whether consumers view different services as substitutes, Mr. Rosin provides ample "evidence that significant numbers of listeners substitute between these two ways of getting music in response to small changes in their relative price or quality" as "empirical evidence of the type that economists would normally rely on to show that interactive services and webcasters are 'reasonably close substitutes.'" IHM PFOF ¶ 306 (quoting Hr'g Ex. PAN 5023 at 43 (Shapiro WRT)). Namely, that "significant numbers of listeners substitute between these two ways of getting music in response to small changes in their relative price or quality." *Id.* While at the $9.99 price, approximately 12% of weekly Pandora and non-interactive service users would be very likely or somewhat likely to subscribe to an on-demand service, at lower price points the likelihood of subscribing greatly increases. Hr'g Ex. PAN 5021 at Figures 6-8. At $4.99 per month, 30% of weekly Pandora and non-interactive service users would be very likely or somewhat likely to subscribe to an on-demand service and at $2.99, a combined 42% would be very likely or somewhat likely to subscribe to an on-demand service. Hr'g Tr. 3758:24-3759:12 (May 14, 2015) (Rosin); Hr'g Ex. PAN 5021 at Figures 6-8. Thus, directly contravening Pandora's claim that "approximately 80% of the U.S. music listening audience simply prefers a 'lean-back listening experience' for which they do not have to pay" (a statistic for which Pandora cites no empirical evidence) (PAN PFOF ¶ 311), Pandora's own survey shows that 42% *would* be likely to pay, albeit at a reduced price point (Hr'g Ex. PAN 5021 at Figures 6-8).

116. Pandora's cross-examination at the hearing suggested an additional criticism that it did not make in its Proposed Findings, but may make in Reply. At the hearing, Pandora suggested that, for the category of users who listen to both Pandora *and* iHeartRadio, many more answered the iHeartRadio substitution question than were given the opportunity to answer the

Pandora substitution question. Under Pandora's theory, the latter group would have answered iHeartRadio, just as the former group answered Pandora. *See generally* Hr'g Tr. 6806:6-6814:4 (May 29, 2015) (Butler). In other words, for users of both iHeartRadio and Pandora, the most likely substitute is the other. Even so, the conclusions to be drawn from the survey are the same: (1) for a large portion of users, Spotify and other higher-ARPU services are the most likely substitutes for Pandora or iHeartRadio; and (2) if no statutory services existed, consumers would turn to directly licensed services *not to terrestrial radio*. Accordingly, even if the criticisms of Ms. Butler's survey were valid, her results still indicate that non-statutory services are the most likely consumer substitute for statutory services.

117. *Third*, the Services' argument, supported by mere conjecture, that interactive and non-interactive services are complements rather than substitutes falls flat. Pandora argues that statutory and non-statutory services are complements. Pandora's "evidence" for this consists of conclusory and factually unsupported statements by Mr. Rosin and other witnesses, who point only to the unremarkable fact that some individuals listen to *both* Spotify and Pandora. The conclusion Pandora tries to draw from these anecdotes has no economic basis. To the contrary, as Ms. Butler explained, consumers familiar with and users of two services are likely to switch from one to the other that they already use.

> So we find that those -- of those people who are respondents who use on-demand services already, they're more likely to indicate that they would shift to an alternative on-demand service if they couldn't listen to Pandora or iHeart. In fact, that's across all of the respondents, so it's not even just for that on-demand listening. People generally shift to a service that they use already.

Hr'g Tr. 6840:23-6841:7 (May 29, 2015) (Butler). Contrary to the Services' argument that use of, for example, Pandora and Spotify, makes these services complements for any particular consumer, they are actually the most likely substitutes for one another.

118. Pandora further argues that Mr. Rosin's survey shows that "Pandora does not cannibalize on-demand services." PAN PFOF subheading IV.C.3.a; *see generally* PAN PFOF § IV.C.3 (¶¶ 310-39). To the contrary, although Mr. Rosin's survey is biased in favor of finding a lack of willingness to subscribe, it nonetheless actually shows a substantial propensity to subscribe among Pandora users. *See* SX PFOF § XIII.C.4.*b* (¶¶ 1132-40) (discussing the methodological flaws in Mr. Rosin's survey that bias it toward a finding of a *lack* of willingness to subscribe, and why the survey nonetheless supports a finding that statutory services interfere with the revenue streams from directly licensed services). In fact, Mr. Rosin's survey supports a finding that Pandora is highly substitutional for revenues flowing to the record industry from subscription services at a rate of between [redacted]. *See* SX PFOF ¶ 1139 (calculating range of potentially lost revenue due to interference by statutory services).

119. Pandora further cites Mr. Rosin's survey for the proposition that Pandora does not draw away listening time or users from on-demand services. PAN PFOF ¶¶ 324-29. This is wrong. First, in Mr. Rosin's Figure 10 questions, he wrongly groups free-to-the-consumer statutory and non-statutory services together. Mr. Rosin asked: "Suppose all free Internet radio ***or music services*** no longer existed…Which of the following would you be most likely to do instead?" Hr'g Ex. PAN 5021 at Figure 10 (emphasis added). Thus, although Mr. Rosin purports to test the substitution between statutory services and services like Spotify, his survey glosses over the very level on which substitution is most likely to happen—the free-to-the-consumer trial or freemium offerings that introduce users to a service and encourage them (or not, in the case of Pandora) to pay for a subscription. Second, in Mr. Rosin's Figure 11

questions, he asks where users and listening time came *from* rather than the method of music listening for which it contemporaneously substitutes. He asks: "Is the time you spend listening to Pandora ***mostly replacing*** the time ***you used to*** spend listening to…?" Hr'g Ex. PAN 5021 at Figure 11 (emphasis added); *see also id.* at Figure 12 (asking the same question for "other non-interactive services"). The relevant question is simply not where users and listening time came "from" or what it is "replacing," but what other method of music listening that user would choose for ***current*** listening time.

120. Profs. Fischel/Lichtman's "listening [hour] caps" experiment likewise fails to show that the services are not substitutes—much less provide information regarding the "market" as a whole or "consumers" generally. *See* IHM PFOF ¶¶ 300, 308. The Pandora 40-hour-per-month cap only impacted that small percentage of most-engaged Pandora users because it applied to only those users double the average listening time. Further, Profs. Fischel/Lichtman did not control for anything else that was (or was not) occurring during the March to August 2013 timeframe, such as the general growth in iHeartRadio at the same time period, or the fact that Spotify Shuffle had not yet been launched.

121. Nonetheless, the two exhibits Profs. Fischel/Lichtman offer as evidence show a remarkably similar pattern in listenership growth between iHeartRadio's custom offering and Spotify's similar custom offering:

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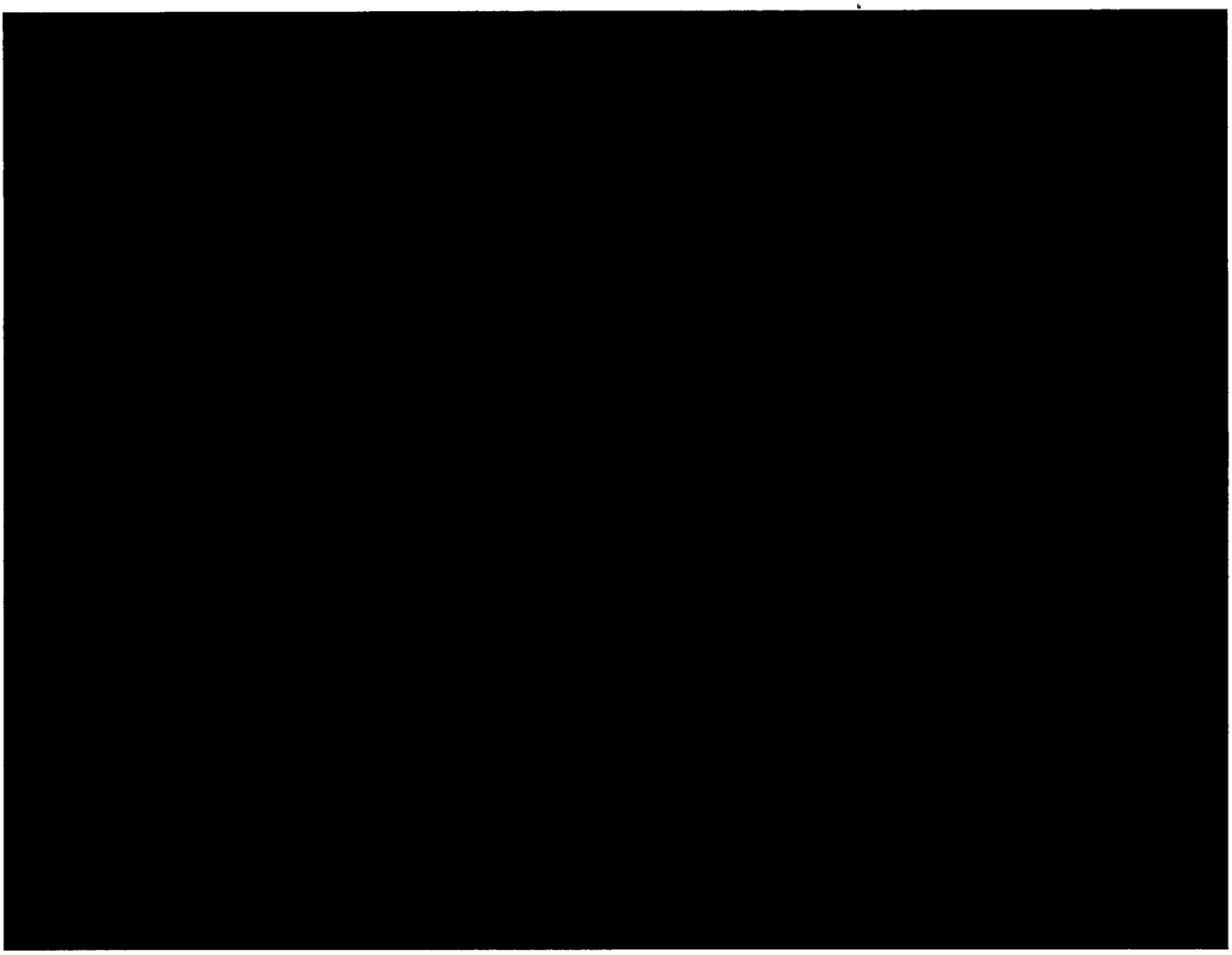

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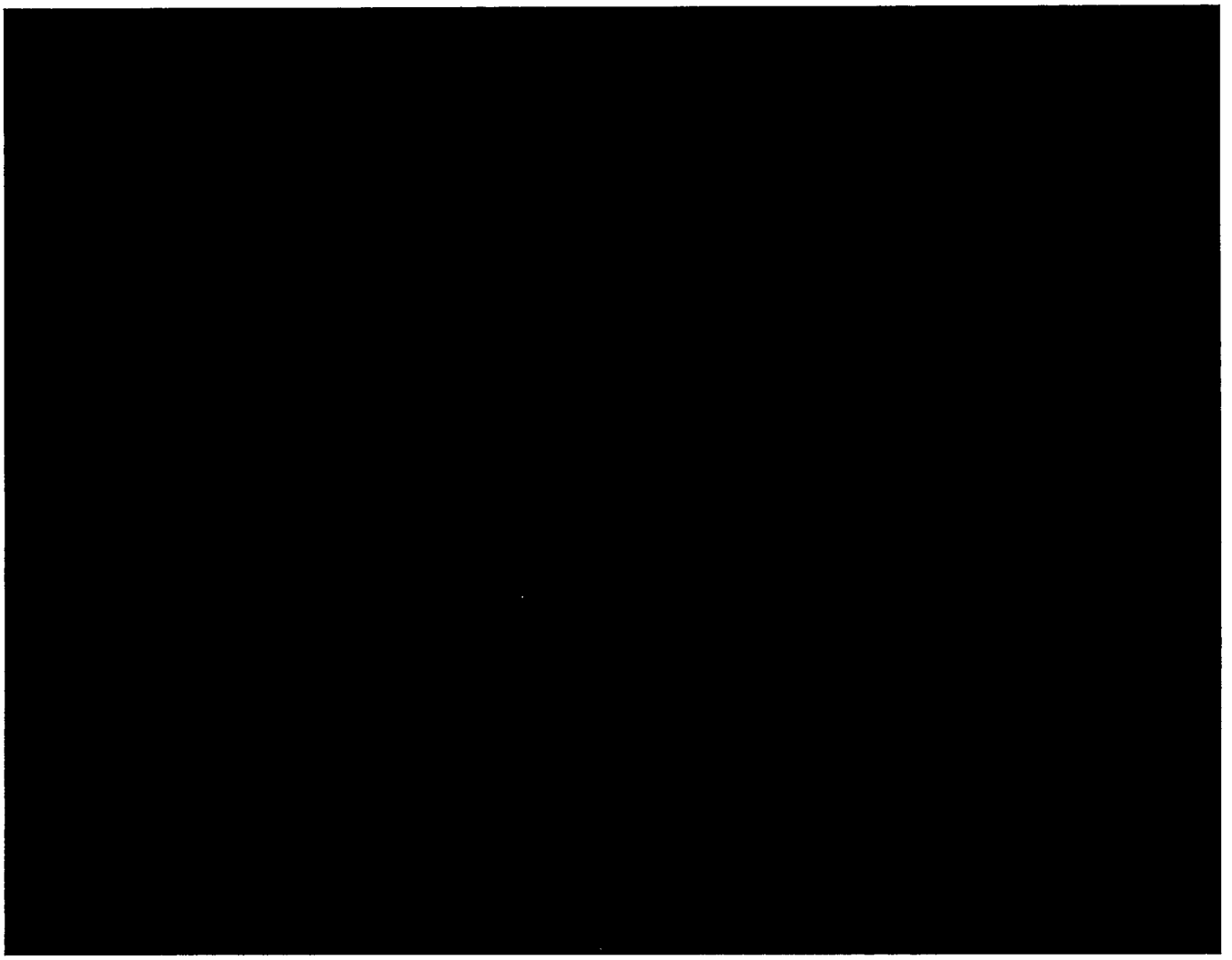


Hr'g Ex. IHM 3054 at Exs. A and B. This is exactly the point at which convergence proves substitution. That iHeart and Spotify show similar patterns vis-à-vis the imposition of the Pandora listening hours cap proves they are substitutes. It makes no difference to the record companies whether consumers are listening to the radio-like feature of Spotify or the on-demand feature—the point is that users were switching from Pandora to Spotify which provides a stronger path to upsell.

122. *Fourth*, the very individuals who are charged with negotiating licenses on behalf of the record companies view statutory services as substitutional and would take that into

account in their licensing. Thus, to the extent that the promotion/substitution statutory factor is merely one example of the information that willing buyers and sellers take into account when licensing, the overwhelmingly consistent record label testimony establishes the sellers understanding of the substitutional nature of statutory services. *See* Hr'g Tr. 977:4-14 (Apr. 30, 2015) (Harrison) ; Hr'g Ex. SX-12 at 18-19 (Kooker WDT).

123. As Mr. Wheeler described it, Beggars Group "cannot afford to be platform agnostic in a consumption-based market"—they want to see consumers streaming music on Spotify, and Mr. Wheeler hesitates to license to services that "dilute the market value" of that consumer listening time. Hr'g Ex. SX-21 ¶¶ 26, 30 (Wheeler WDT). Mr. Wheeler's view is that statutory services "offer enough of a complete music experience . . . to draw consumers away from the higher-revenue-per-consumption services." Hr'g Ex. SX-21 ¶ 31 (Wheeler WDT). Those record company employees tasked directly with revenue generation and sales view the landscape similarly. As Ms. Fowler explained:

> If anything, consumption of music on statutory services reduces users' interest in or desire for subscribing to higher-ARPU interactive services. I am not aware of any marketplace evidence showing that the use of statutory services promotes users to sign up for on-demand subscription services. In the music-access world, the substitution of statutory services for directly licensed subscription services undermines one of our most important sources of revenue generation.

Hr'g Ex. SX-7 ¶ 6 (Fowler WRT).

124. Accordingly, whether as a matter of actual consumer substitution patterns or perceived interference, the evidence shows statutory services undeniably are substitutes for non-statutory, directly licensed services. As explained in Section II.B.1 *supra* and SoundExchange's Proposed Findings of Fact, Section V.B, the shift from an ownership to an access model for the recorded music industry means that substitution *between* access-based services will be that much

more central to record companies' licensing efforts over the next rate term. As Mr. Wheeler testified, a statutory rate that does not account for this substitution would "dilute the market value" of recorded music. Hr'g Ex. SX-21 ¶¶ 26, 30 (Wheeler WDT).

ii. The record does not support the Services' argument that statutory services *promote* physical and digital sales of recorded music

125. Contrary to the Services' arguments that statutory services promote physical and digital purchases, the evidence in the record suggests that they do not generate additional revenue for the record industry, both as a matter of fact and as a matter of perception. Record labels do not view streaming services as promotional vehicles at all, but rather as consumption platforms—or ends in of themselves.

126. Because the Services offer different arguments on the issue of promotion/substitution to sales, this section addresses each in turn. Of course, these distinctions do not capture the variety of service offerings, including for example programmed, non-simulcast streams. Regardless of the type of streaming, the evidence does not prove that digital streaming services as a general matter encourage listeners to purchase physical or digital copies.

(A) Customized Offerings

127. Although Pandora alludes to evidence that it is promotional of sales, its Proposed Findings of Fact are thin at best on evidence that Pandora promotes sales—focusing almost exclusively on a single Sony document and Dr. McBride's study. *See* PAN PFOF at ¶ 361 n.51 (alluding to "considerable empirical evidence" but citing only Dr. McBride and no other evidence). iHeart, on the other hand, cites numerous documents but puts forward unconvincing arguments not supported by the actual market evidence. The Services' arguments are addressed herein, but it is first important to clarify the most relevant evidence—the views of willing buyers and willing sellers.

128. The evidence reveals that both copyright owners and services recognize that the robust, satiating nature of customized offerings serves as a disincentive for users to make purchases, particularly of digital downloads. Accordingly, both sides would take this substitutional effect into account when licensing for customized streaming services.

129. As Mr. Kooker testified, the fact that customized stations give individual consumers programming that is uniquely tailored makes it "increasingly difficult to persuade that consumer that they should buy tracks or albums." Hr'g Ex. SX-12 at 19 (Kooker WDT). The evidence was clear that the simple fact of listening to a sound recording does not encourage consumers to buy a copy. Consumers have to be in an environment that encourages purchasing rather than more consumption on that platform. Customized streaming does not encourage purchasing. To the contrary, as record companies view it— "If a user has 'customized' her or his preferences through a streaming service, the user knows they have a good chance of hearing songs they like, or others like them, and thus see diminished need to own the particular recording." Hr'g Ex. SX-10 ¶ 10 (Harrison Corr. WDT). Accordingly, record labels have predicted that sales, particularly of downloads, will "continue to decline into the foreseeable future." Hr'g Tr. 368:4-16 (Apr. 28, 2015) (Kooker); *see also* Hr'g Ex. SX-10 ¶ 11 (Harrison Corr. WDT).

130. Likewise, artists and artists' representatives see the substitutional impact that music streaming services have had on purchases of music. As Mr. Hair testified: "digital performance royalties are important because patterns of music consumption are changing, so that 'listening' is replacing 'purchasing.'" Hr'g Ex. SX-8 at 5 (Hair WDT).

131. It is simply not true as iHeart asserts that "Record labels have increased their promotional efforts to include digital radio, including services like iHeartRadio and Pandora."

IHM PFOF ¶¶ 100, 138. Record label witnesses testified at length that [redacted]. Hr'g Tr. 6997:6-11 (June 1, 2015) (Fowler). Even iHeart's witness, Mr. Charlie Walk of Republic Records, testified that [redacted] Hr'g Ex. IHM 3242 at 38-39 (Walk Dep. at 147:7-15, 149:24-150:5). It is not the mere existence of a few marketing or promotional efforts for particular artists, but the relative amount of promotional efforts directed toward the service, and in that regard custom webcasting is a mere fraction of all efforts both as compared to directly licensed partners and terrestrial radio, *see infra* (discussion regarding marketing plans).

132. On the Services' side, Mr. Pittman admitted that, outside of this litigation, [redacted]. Hr'g Tr. 4858:10-18 (May 20, 2015) (Pittman); *see also* Hr'g Ex. SX-373 ([redacted]); Hr'g Ex. SX-1028 at 1 (same); Hr'g Ex. SX-1683 at 5 ([redacted]). And, while Pandora and iHeart alike tout that they have a "Buy Button"—no Service presents any data on the number of purchases actually made through those links. Dr. Blackburn's analysis of Pandora's Buy Button demonstrated [redacted]. *See* SX PFOF ¶¶ 1165-66; Hr'g Ex. SX-24 (Blackburn WRT). Finally, try as they might to prove that even the Services' *promotional* programs impacted the bottom line of the record companies, internal iHeart documents show that [redacted]

[redacted]]. Hr'g Ex. SX-207.

133. Furthermore, although iHeart quotes Mr. Charlie Walk (offered through his deposition testimony) for the proposition that all forms of streaming are promotional and just as promotional as terrestrial radio, Mr. Walk testified otherwise. He explained that "[s]imulcast is not a word that comes up in our promotion calls or meetings or conversations regarding the promotion of our acts," (Hr'g Ex. IHM 3242 at 20 (Walk Dep. at 75:2-5)) and when asked specifically whether simulcast would have the same promotional impact as terrestrial radio, he testified that he did not know. *Id.* at 33 (Walk Dep. at 129:6-9).

134. As a general proposition, the rights owners and services' perceptions of substitution are consistent with the market trend. The trend of falling revenues in the recorded music industry has continued in the years since Pandora has grown to its current prominence (2008 to present). *See* SX PFOF § XIII.C.2 (¶¶ 1112-19). Revenues have dropped by approximately $3 billion since 2008; in that same time period, Pandora has grown from a nascent company to one with over 80 million active users. Hr'g Ex. SX-24 at 15 (Blackburn WRT); *see also id.* at 17-18. Although Pandora argues that revenues have been *flat* in the recent years as Pandora has continued to grow (PAN PFOF ¶ 367 (citing Prof. Shapiro's discussion of stabilizing revenues))—2013 to 2014 saw a 12% decrease in download sales (from $1.486 billion to $1.305 billion) (Hr'g Ex. SX-12 at 13 (Kooker WDT)).

135. Pandora and iHeart flips the economic relevance of the market decline—as an influence on sellers' willingness to license at below market rates in a declining economy—on its head and argues that the decline in industry revenues is *irrelevant* to the rate-setting proceeding. Pandora PFF § IV.E; *see also* IHMPAN PFOF § I.E.2. No "presumption" exists that statutory

streaming is promotional. The witnesses from the record labels overwhelmingly agree that webcasting has contributed to—not stemmed—the pattern of decline. Pandora and iHeart offers a number of other *possible* causes for the continued decline in revenues in the face of increased streaming. No fact witnesses, however, testified that these causes, and *not webcasting*, have contributed to the decline in industry revenues.

136. The particular relevance of the continued decline in market revenues is how it impacts a willing sellers' frame for negotiation. Record companies are cognizant of the market conditions and must price their licensing (and other revenue streams) accordingly to ensure they can continue to invest in new music and be profitable.[8] For example, Mr. Harrison testified:

Hr'g Tr. 977:4-14 (Apr. 30, 2015) (Harrison). Record companies are seeking to license to higher-ARPU services and the extent to which Pandora's robust, personalized, consumer offering satiates listeners who might otherwise pay for a subscription or use a higher-ARPU service would impact the rates to which a willing seller would agree. As Ms. Fowler explained:

> Pandora and other statutory services that are ad-supported and free-to-the-listener do not generate high ARPU returns for the streaming consumption of a record company's core product. If anything, consumption of music on statutory services reduces users' interest in or desire for subscribing to higher-ARPU

[8] This is why Prof. Rubinfeld's remark that promotion is quickly becoming an anachronism is not so far afield. Hr'g Ex. SX-17 ¶ 161(Rubinfeld Corr. WDT). Promotion means less in a declining market because there are fewer sales overall.

> interactive services. I am not aware of any marketplace evidence showing that the use of statutory services promotes users to sign up for on-demand subscription services. In the music-access world, the substitution of statutory services for directly licensed subscription services undermines one of our most important sources of revenue generation.

Hr'g Ex. SX-7 ¶ 6 (Fowler WRT).

137. iHeart puts forward two primary arguments as to why statutory services generally are promotional: (1) starting with the fact that record labels have traditionally devoted substantial time promoting to *terrestrial* radio—"[t]he importance of radio promotion does not diminish as music listening moves online. . . . Whether a song is heard on digital radio or terrestrial radio, the result is the same: greater exposure results in increased sales." IHM PFOF ¶ 100; and (2) evidence that certain record companies sought to increase their *revenues* from statutory services (including the iHeart-Warner agreement) sometimes through increasing performances on those services proves record companies view statutory services as promotional. IHM PFOF ¶¶ 101, 127-37.

138. Regarding the first of these arguments, iHeart cites a single document from SoundExchange and a single line of Mr. Huppe's testimony in its entire section purporting to explain that "Digital Radio Is Radio, and Promotes in the Same Way as Terrestrial Radio." IHM PFOF § II.C ¶¶ 123-26. iHeart does nothing to address the remarkably different listening environment provided by customized and personalized streams or any of the record label witnesses' testimony as to why they view these services as fundamentally different from terrestrial radio. As iHeart's own documents point out, however, the digital environment *is* different. *See* Hr'g Ex. SX-2207. Mr. Kooker demonstrated the difference at great lengths in his testimony:

> From our experiment, a motivated user has a 100% chance of hearing either "All About That Bass" or "Lips Are Movin"

> instantly on iHeartRadio's custom radio service. By way of comparison, the chance of turning on the radio and hearing either song on one of the local terrestrial radio stations that I mentioned in footnote 4, for the same week (February 4-10) is very small by comparison. The chances are 1.36% on Z100 and 1.60% on KIIS FM (dividing the total amount of airplay for both songs by the amount of total available airplay in a week).

Hr'g Ex. SX-27 at 8 n.7 (Kooker WRT). When conducting iHeart and Pandora "Top 20 Artists" experiments using the top 20 artists on the Billboard charts to simulate a playlist-like experience, Mr. Kooker found that for iHeart Top 20 Artists:

- 100% of the time the first song played was by the requested artist.
- 50% of the time the second song played was also by the requested artist.
- 100% of the time three or more of the first five songs were by the requested artist or a "featured artist."

Hr'g Ex. SX-75 at 1. Likewise, for Pandora Top 20 Artists:

- 100% of the time the first song played was by the requested artist.
- 95% of the time the requested artist played twice within the first five songs.
- 85% of the time at least three of the first five songs were by the requested artist or a "Similar Artist."
- 50% of the time at least four of the first five songs were by the requested or a "Similar Artist."

Hr'g Ex. SX-75 at 1. This is to say that *much less* a terrestrial radio experience which combines exposure with limited access, the customized streaming services give close to unlimited access to the most well-known and popular artists. As a result, there's little need for anyone to buy the sound recordings.

139. The second of iHeart's arguments points to the direct licenses offered as benchmarks by Pandora and iHeart and asserts that the record labels sought out the agreements to increase their market share on those services and thereby obtain the promotional benefits.

IHM PFOF ¶¶ 127-37. This neglects the obvious economic reason they entered into the agreements—they could achieve an overall amount of revenue *from that particular statutory service* at a rate greater than what they would have received through SoundExchange. In other words, this was not about "other streams of revenue" at all. 17 U.S.C. § 114(f)(B)(2). iHeart is correct that the majority of the record labels who entered into these agreements wanted more performances of their content *because* more performances earns them greater revenues. iHeart cannot reconcile this with Mr. Wilcox's [redacted] so it deems his testimony "not credible." IHM PFOF ¶ 133. Mr. Wilcox's testimony, however, is perfectly rational because [redacted]. Hr'g Ex. SX-33 at 2, § 1(e); 11, § 1(qq). [redacted].

140. Another reason exists that record labels would want more performances on iHeart*Media*'s simulcast service—terrestrial radio. To the extent the programming is the same (though not identical, as explained below), record companies would want simulcast performances to increase with the hope that it would increase their share of terrestrial performances through a [redacted] Hr'g Ex. IHM 3326 at 19. The [redacted]. Mr. Wilcox responded directly to this point at the hearing:

[redacted]

Hr'g Tr. 2430:20-2432:2 (May 7, 2015) (Wilcox).

141. Finally, iHeart makes reference to record companies' participation in the DAIP program. IHM PFOF ¶¶ 140-43. As explained in SoundExchange's Proposed Findings of Fact, this program, like On the Verge, AIP, etc., is a *promotional* program, and the fact that record companies waive royalties for a specific song call-out and message regarding where to buy it is very different from the statutory performances that are being licensed here. *See* SX PFOF ¶¶ 1175-76. If anything, it proves that typical statutory performances are not promotional.

142. As expected, Pandora also points to Dr. McBride's "Music Sales Experiments" as evidence that Pandora promotes sales. PAN PFOF § V.B. Pandora admits, however, that Dr. McBride's study does not prove *expansionary* promotion. PAN PFOF ¶ 407. In other words, Pandora recognizes that Dr. McBride's testimony sheds no light on whether, as a general matter,

consumers' use of Pandora as a whole increases or decreases the amount they spend on purchases of physical and digital copies of sound recordings. In Pandora's view, all that matters is "Pandora's proven ability to promote the particular repertoire that it plays." *Id.*

143. As Pandora knew at the time it designed them, the experiments do not address the relevant question of expansionary promotion:

> The ***main concern*** with the reliability of the results of this experiment is that it ***does not directly address the issues raised by the music industry.*** If Pandora as a service substitutes listeners away from buying music *in general*, that might not show up in an experiment where we turn off a single song.

Hr'g Ex. SX-24 at App. 3 (Blackburn WRT) (first two emphases added). Subsection II.B.3.*c infra,* discusses this steering/diversionary promotion argument directly. Pandora's unsupported argument that record companies would *not* care about the substitutional effect to industrywide revenues (or the promotional effect, if there were one) wrongly assumes that a record company would not withhold its catalog or seek higher rates if a service were going to cannibalize other streams of revenue. This is exactly the opposite of the assumption built into the statutory factor and supported by the evidence in this case. *See* Hr'g Tr. 977:4-14 (Apr. 30, 2015) (Harrison) (discussing [ ]).

144. Even if we were to accept Dr. McBride's results, these results cannot be extrapolated to *other* statutory services and cannot be applied as a blanket matter to the statutory license. As described in SoundExchange's Proposed Findings of Fact, Dr. Blackburn's analysis of iHeartRadio data from the time before and after implementation of the iHeart-Warner agreement proves that iHeartRadio [ ]. *See* discussion SX PFOF ¶ 1115-19. Dr. Blackburn found that while [

[redacted]. Hr'g Ex. SX-24 at 21, Table 1 (Blackburn WRT). Accordingly, whatever the result for Pandora, they are certainly *not* true for iHeartRadio.[9]

145. Furthermore, Pandora provides no response to Dr. Blackburn's critique that the mismatch between Pandora users "listening" zip codes and their "purchase" zip codes undermines the randomization of his experiment. To the contrary, Pandora trumpets the randomization as why the experiment qualifies as the purported "gold standard," but the errors in the data undermine the randomness of the experiment—particularly the overrepresentation of the popular television zip code 90210. In addition, Dr. McBride's experiment is only a snapshot in time—a time that will be a year dated by the time of closing arguments in this case and in an industry that is moving quickly and continuing to see declines in physical and digital purchase. In short, his experiment cannot speak to the promotional or substitutional effect over the next five years.

146. iHeart echoes Pandora's endorsement of Dr. McBride's Music Sales Experiment, but suggests that these experiments actually show a general promotional effect of Pandora. This is wrong for the reasons explained above, and even Pandora has now walked away from such a bold claim.

147. iHeart also continues to rely on what it deems a "rigorous empirical analysis" conducted by Dr. Kendall. IHM PFOF ¶ 100; *see also id.* PFOF ¶¶ 146-49. SoundExchange discusses the fundamental flaws with the survey in more detail in Section II.B.3.b, *infra*. Apart

[9] For this reason and others, the iHeart-Warner, iHeart-Independent, and Pandora-Merlin agreements cannot be assumed to incorporate the willing buyers' and willing sellers' assessment of the promotional/substitutional considerations as a general matter.

from his conclusion that non-interactive and interactive services have purportedly *different* promotional effects, Dr. Kendall's finding that music streaming services generally, and non-interactive ones specifically, are promotional is unreliable and certainly does not "likely understate[] the promotional effect" at all. *See* IHM PFOF ¶ 149. Unlike a conservative or rigorous study, the very design is biased toward finding promotion because unobserved variables could be impacting both time spent listening and purchasing. For example, if a listener is introduced to a new artist—say Vampire Weekend—by her favorite TV show, she may *both* go buy the album *and* start a Vampire Weekend station on Pandora that she listens to more than she otherwise would. Dr. Kendall's "fixed effects" model does nothing to control for this likely occurrence that biases his results in the *positive* direction.[10] *See* Hr'g Ex. SX-24 ¶ 47 (Blackburn WRT) (explaining how his recreation of Prof. Danaher's study is biased positive in the same regard).

148. iHeart makes one final empirical claim that is misleading. iHeart argues that Dr. Blackburn's recreation of Prof. Danaher's study—which with a number of caveats, analyzed discovery events (not time spent listening) and measured whether users who "discovered" non-interactive or interactive streaming purchased more music as a result—supports its position that non-interactive streaming is promotional. *See* IHM PFOF ¶ 154-58. Not so. First and foremost, iHeart quotes certain numbers that purportedly show promotion that Dr. Blackburn only includes in his analysis with the following caveat: "While, in my opinion, this restriction is inappropriate, I do it simply because Professor Danaher did so in his testimony, which has since been withdrawn. See, for example, Corrected Danaher Testimony, ¶12. I discuss the results omitting

[10] Dr. Kendall offers four untested and unsubstantiated reasons why he believes his study might understate the promotional effect, but each of these rationales is just as likely to *overstate* the effect—he simply does not know. *See* IHM PFOF ¶ 149.

this restriction below." Hr'g Ex. SX-24 at 28 n.52 (Blackburn WRT). In other words, iHeart relies entirely on a set of numbers that Dr. Blackburn *does not endorse* but merely includes for completeness because Prof. Danaher did.

149. Furthermore, iHeart fails to acknowledge Dr. Blackburn's primary conclusion—all of the results are statistically *indistinguishable from zero.* Hr'g Ex. SX-24 ¶ 42 (Blackburn WRT). In positing that Dr. Blackburn found a promotional effect, iHeart further fails to acknowledge that Dr. Blackburn ultimately concluded: "As a result, while these results indicate that the average increase in purchases of digital tracks by users who adopted Pandora or iHeartRadio is statistically indistinguishable from zero, it should be noted that even this estimate is biased upward. Hence, the true expansionary impact of non-interactive services is lower than the estimate[s]s in [Dr. Blackburn's Table, Column (c)]." *Id.* ¶ 49.

150. Finally, on a record void of empirical evidence of promotion, the Services point to a handful of documents that they claim prove definitively that webcasting services promote sales. Prof. Shapiro, Pandora's expert, admitted that they prove no such thing: [redacted] Hr'g Tr. 2715:19-21 (May 8, 2015) (Shapiro). He further admits that he did not have sufficient information to analyze the very few internal record company documents that he reviewed, and that he could not propose a promotion adjustment from the information contained in the internal documents:

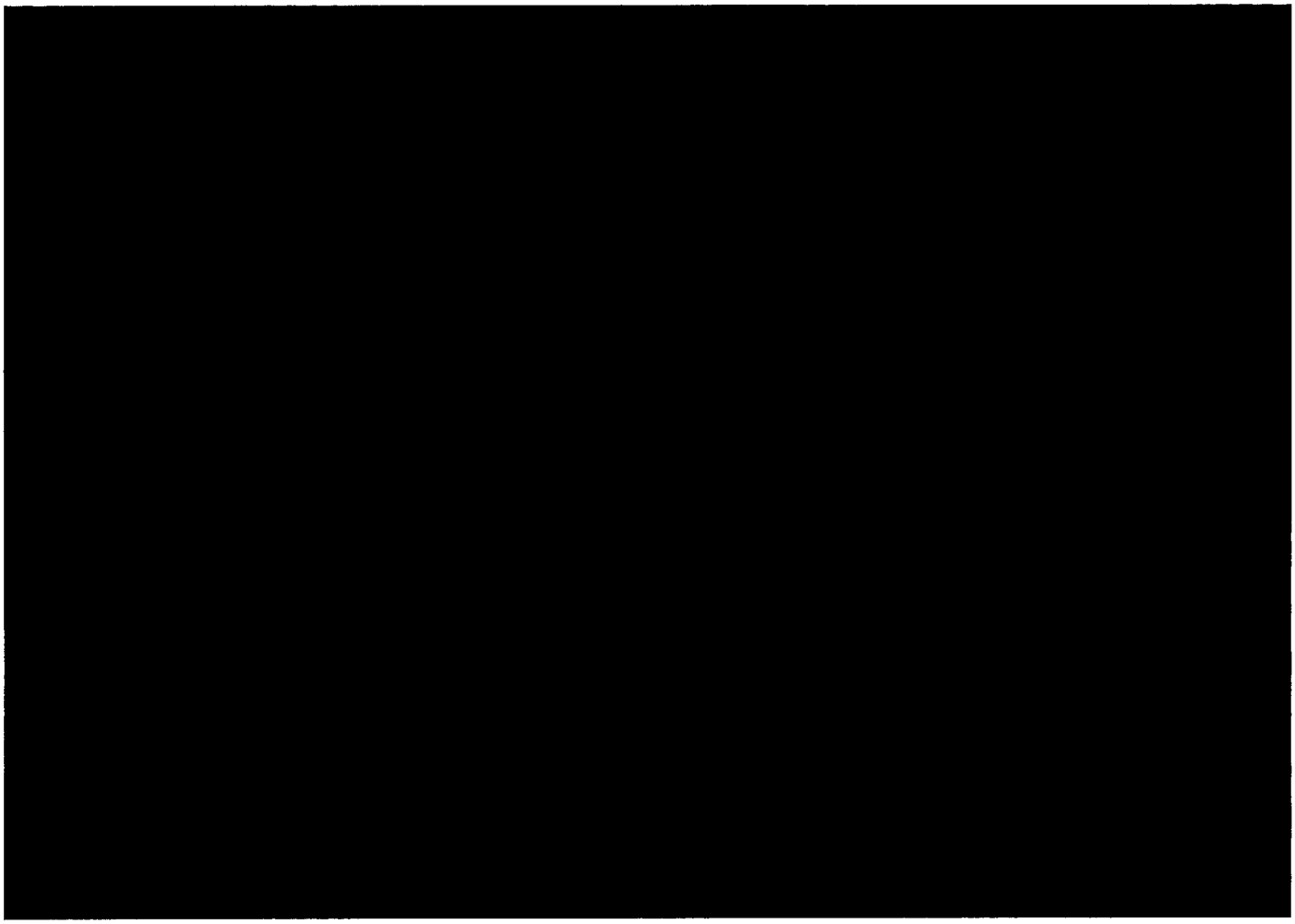
Hr'g Tr. 2720:15-23 (May 8, 2015) (Shapiro). Prof. Katz agreed:

> Q. No, in fact, a fair reading of the documents we've seen here is that the documents say contrary things sometimes, right?
>
> A. I certainly agree that the documents sometimes will disagree on the effects of particular services, yes.
>
> Q. You would believe that that probably would be the case in an industry that is rapidly changing, correct?
>
> A. That's certainly something that could give rise to this agreement, yes.

Hr'g Tr. 3053:2-12 (May 11, 2015) (Katz).

151. And, in fact, none of the Services cite to the documents, usually more recent in time, and likewise internal to the record companies that show very clearly Pandora substituting for download sales. For example, SoundExchange Exhibit 2077:

RESTRICTED IMAGE



Pandora argues that "one need look no further than Sony's own files" referencing a strategy presentation (PAN PFOF ¶ 256); but the above excerpted document was *also* in Sony's files and points in the opposite direction. When confronted with this document at the hearing, Dr. Katz admitted that "Yes, I would give some attention to it, yes." Hr'g Tr. 3058:9-10 (May 11, 2015) (Katz).

(B) Simulcast Offerings

152. NAB and NRBNMLC contends that simulcast—more than customized streaming—promotes the purchase of physical and digital copies of sound recordings. *See* NAB PFOF § III.C ("SIMULCASTING IS RADIO AND IS MORE PROMOTIONAL AND LESS SUBSTITUTIONAL THAN OTHER WEBCASTING"); NRBNMLC PFOF § III.C. However, with respect to simulcast in particular, none of NAB, NRBNMLC, or iHeart (collectively "Broadcaster Services") offered an empirical study regarding the impact of simulcast specifically on sales and offer no way of quantifying the impact that they purport exists and that they purport is *greater* for simulcasts than it is for other forms of webcasting. The Broadcaster Services further cannot point to simulcast-specific documents internal to the record companies or services showing that simulcast streaming (not promotional programs) *itself* has a direct promotional effect on sales.

153. The Broadcaster Services' central argument as to why simulcast services are promotional turns completely on the comparison they draw to terrestrial radio. They build a case focused on facts and arguments regarding why and how *terrestrial* radio (*not digital*) plays a role in exposing listeners to new music and incentivizes sales. *See, e.g.*, IHM PFOF ¶¶ 96-122 (exclusively discussing terrestrial radio); NAB PFOF ¶¶ 82-118. Because this proceeding is not about terrestrial radio or a terrestrial performance right, SoundExchange will not take on these

arguments here—they are beside the point. Starting from an assumption that terrestrial radio promotes, the Broadcaster Services then pivot and ask the Judges to conclude that simulcasting (and in iHeart's case, also custom streaming)[11] has the same purportedly "promotional" role (and will have the same role going forward in this changing music industry). The flaw in their reasoning, however, is that it turns on two assumptions that the record shows false: (1) the listening experience is the same to simulcast services as it is to terrestrial radio; and (2) the programming is identical (which it is not). *See, e.g.*, IHM PFOF ¶ 100. As explained herein, this leap in logic is not supported by the evidence and certainly is not "beyond serious dispute," as iHeart boldly asserts. IHM PFOF ¶ 124.

154. *First*, as explained in SoundExchange's Findings of Fact, *exposure* or "*music discovery*" can be a necessary, but is never a sufficient, condition for generating revenue. Contrary to iHeart's contentions that "repeated exposure" is all that matters, there must also be an *incentive* for the consumer to open her/his wallet to pay for music. IHM PFOF ¶¶ 96-99. The Broadcaster Services do not address this environmental factor all even though their witnesses and documents describe digital radio as having a [redacted] Hr'g Ex. SX-2207; *see also* Hr'g Tr. 3658:12-23 (May 13, 2015) (Poleman) (confirming that iHeart [redacted]

[11] To the extent that iHeart does not distinguish between its custom and simulcast offerings in making general arguments drawing comparison between terrestrial radio and webcasting—the analogy to terrestrial radio is even *less* apt for customized streaming. The listener experience of a personalized stream is different and, of course, the sound recordings are not the same as that programmed on terrestrial radio.

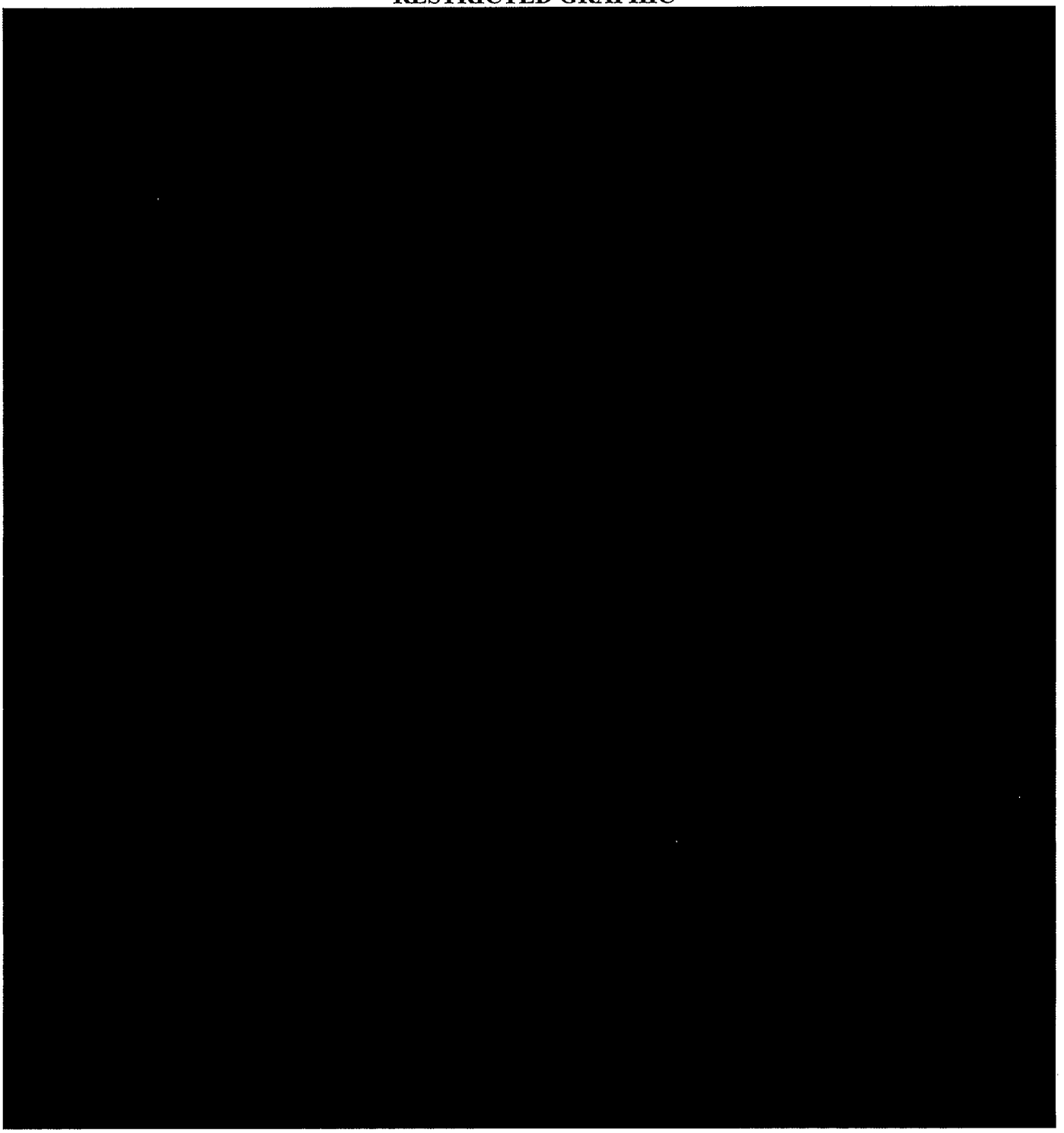
155. Numerous witnesses testified that the simulcast experience discourages purchasing both because it satiates demand for music listening and because it is "everywhere." Indeed, simulcasters are actively pursuing this sort of satiation and omnipresence. iHeart developed iHeartRadio to "make the local radio programming they love available in more places and on more devices—at home, in their cars, and now on their computers, smartphones, and tablets." Hr'g Ex. IHM 3222 ¶ 9 (Pittman WDT). As Mr. Dimick testified, simulcasters want to be wherever their listeners are: "And so, you know, trying to be in all places, the same with HD, is to have our services there where listeners might find us. So -- because they start moving over to streams, you know, we want to be there like everybody else, like our competitors." Hr'g Tr. 5836:20-25 (May 26, 2015) (Dimick).

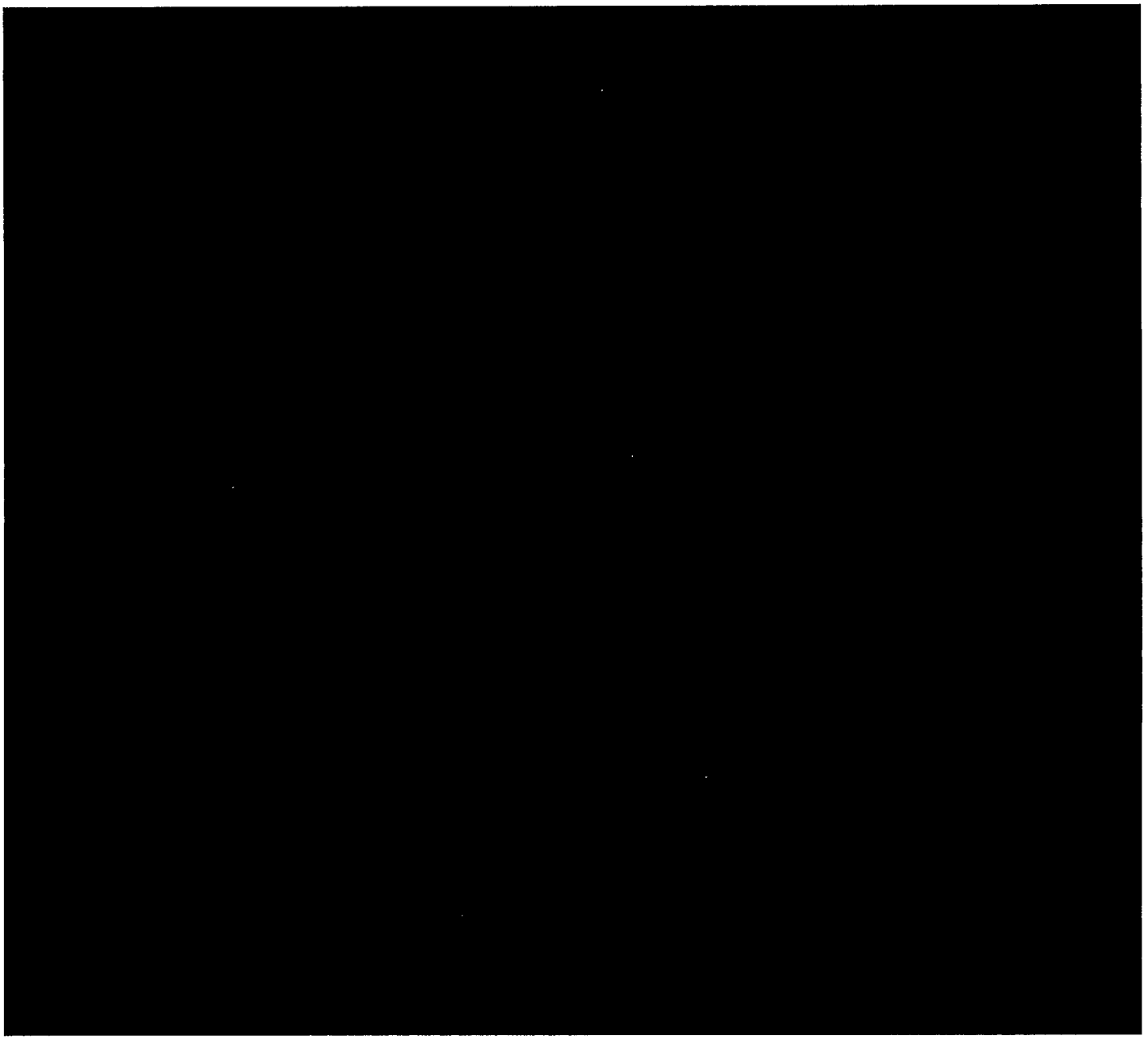
156. *Second*, the record company documents do not treat simulcasters (or, for that matter Pandora) the same as terrestrial radio. Promotion—in the traditional sense is a highly coordinated plan timing exposure events around the release of a single and/or album aimed to generate sufficient awareness but also an environment that encourages purchasing.[12] Mr. Kooker and Mr. Harleston describe these efforts in their written testimony including the individualized design of each plan across particular platforms, carefully coordinate to optimize that artist's chances for success. *See* Hr'g Ex. SX-12 at 4-5 (Kooker WDT); Hr'g Ex. SX-9 ¶ 23 (Harleston WDT); *see also* SX PFOF § IV.B.4 (¶¶ 196-203). More and more these efforts are turning to

[12] Contrary to iHeart's assertions that radio and radio only is responsible for artists' and records' successes, *see, e.g.*, IHM PFOF at 53 n.12, ¶ 120, Mr. Poleman, President of National Programming Platforms for iHeart admitted that, at least with respect to Sam Smith, [redacted]. Hr'g Tr. 5204:2-13 (May 21, 2015) (Poleman).

involve directly licensed music streaming partners, such as Spotify. A typical marketing campaign timeline looks like this:

RESTRICTED GRAPHIC





Hr'g Ex. SX-444 at 3-4. A review of the sample of marketing plans in evidence—marketing plans that the Services sought in discovery and admitted—show that efforts spent on terrestrial radio are nowhere near matched by references to simulcasting, let alone Pandora. The efforts directed at simulcasters (or Pandora) are far outweighed by those targeting directly licensed services such as Spotify. *See, e.g.*, Hr'g Exs. SX-444, IHM 3162, IHM 3165, IHM 3201 (of the dozens of pages of marketing campaign data, references to simulcasters and Pandora are sparse

at best). iHeart admits as much claiming, for example that [redacted].

IHM PFOF ¶ 106.

157. Record label witnesses further testified that they do not see simulcasting as having a similar promotional impact as terrestrial radio. *See* Hr'g Ex. SX-4 ¶¶ 8-11 (Burruss WRT); Hr'g Tr. 7044:7-13 (June 1, 2015) (Burruss).

158. *Third*, as Prof. Katz conceded, he did not (nor did anyone else) do *any* empirical work to determine whether simulcasting is actual promotional. Hr'g Tr. 5758:10-11 (May 26, 2015) (Katz) ("[T]o your question have I conducted my own empirical study, no."). The broadcaster participants (and SiriusXM if they are to be considered a broadcaster) offered no survey expert, empirical expert, or other work attempting to isolate the promotional effect of simulcast *or* terrestrial radio. The NAB and NRBNML simply rely on conclusory statements without any ability to quantify the purportedly great and greater-than-customized promotional effect of simulcasting.

159. Likewise, the programming that both NAB and iHeart contend is exactly the same on webcasting as it is on terrestrial radio is not. The record reflects numerous respects in which simulcast stations *diverge* from the programming on terrestrial radio stations. iHeart's rate proposal makes the point obvious—it defines simulcast as having up to 49% *different* content than the terrestrial radio broadcast. Likewise, the aggregator websites like TuneIn allow for functionality that changes the stream from what is available on terrestrial. Listeners can pause or save tracks for listening later. Hr'g Tr. 5850:9-5851:7 (May 26, 2015) (Dimick).

160. Contrary to iHeart's mere assertion that the "experience, from the point of view of the consumer, is identical" (IHM PFOF ¶ 124), the simulcast offering is fundamentally different from that of terrestrial radio in a number of different ways:

- Because simulcast is available on mobile, there is no reason to purchase downloads for listening on a mobile device let alone listen to other streaming services. As Mr. Kooker explained:

  "The ability to search *all* (or a selected portion) of iHeartRadio's simulcast stations in musical genre or a geographic region and immediately identify and access specific artists and/or songs being played, or alternatively, search for a specific artist and immediately access that artist's music from various simulcast stations, make iHeart's simulcast service fundamentally different from terrestrial radio." Hr'g Ex. SX-27 at 6 (Kooker WRT).

- Simulcasts have no geographic restrictions, which means "listeners of simulcast stations can choose from thousands of radio stations that are available across the country or across the world" and that he listens to simulcast stations from "Texas, Los Angeles, France and Germany" despite living the Bay Area. Hr'g Tr. 5757:1-13 (May 26, 2015) (Katz).

- As Mr. Littlejohn testified in response to questions from an iHeart document describing iHeartRadio as [redacted] Hr'g Tr. 3658:12-3659:1 (May 13, 2015) (Littlejohn).

- These features make the listening experience distinct from that of terrestrial radio:

  [W]hen you're in the terrestrial mode with an AM/FM dial in front of you, and you're interested in a given type of music, you have limited choices. You may have -- there may be only one station in your area that has that genre. There may be a couple. That's probably the most. And that goes to the issue of promotion in that situation of playing music can be -- could be promotional, particularly if we're not receiving any money from it. Hr'g Tr. 2522:9-2523:9 (May 7, 2015) (Wilcox).

- As Mr. Kooker's testimony made clear—the same hit song that might be available nearly instantaneously on iHeartRadio could very well only be playing two times (Los Angeles) or six times (New York) a week while almost instantly on iHeartRadio or TuneIn. Hr'g Ex. SX-27 at 6-7 (Kooker WRT). This is because iHeartRadio "lets users find more than 1,500" simulcast stations on a single service. IHM PFOF ¶ 12. The increased ability to access the song is not *more*

> *exposure* and therefore *more promotion* as iHeart purports. To the contrary, instantaneous access is what the record labels and subscription services seek to offer at a premium subscription price.

Accordingly, simulcasting is not the exact duplicate of terrestrial radio and the evidence shows that it is not promotional and gives no basis for the Broadcasters' assertions that there should be an adjustment to that effect.

iii. Webcasting has a clear and obvious net substitutional effect on other streams of revenue that will only increase over the next rate term

161. In total, the "net" promotion/substitution calculation is easy. The record is undisputed that statutory webcasting services of all kinds substitute for other streaming services (which will only increase over the next rate term as sales continue to decline and streaming continues to grow)—a clearly "negative" or substitutional effect. Add to this lack of convincing and reliable evidence that webcasting services actually promote sales—a net effect of zero. Negative plus nothing is still negative. Hence, § 114(f)(2)(B)(i) requires the Judges to take into consideration in the willing buyer/willing seller rate the fact that statutory webcasting over the 2016-2020 rate term will substitute for/interference with other streams of copyright owner revenue.

b. No evidence demonstrates (let alone reliably quantifies) that the interactive benchmark services have a different net impact on the physical and digital sales than do statutory services generally

162. The Services argue that Prof. Rubinfeld's interactive services benchmark requires further adjustment to account for the difference in promotional impact between non-interactive and interactive services. IHM PFOF ¶¶ 294-95; NAB PFOF ¶¶ 388-99. But the record utterly failed to show such a difference with any reliability and as a result, the record does not support any particular adjustment number and any adjustment would be arbitrary.

163. Only two of the empirical studies in this proceeding attempted to measure the difference in promotional and substitutional effects on sales between non-interactive and interactive streaming services—Dr. Kendall and Dr. Blackburn. Dr. McBride's study does not analyze interactive services at all and therefore cannot show any difference between Pandora and a comparable interactive service, such as Spotify. Nor does Pandora claim that it does.

164. The flaws in Dr. Kendall's experiment are discussed at length in SoundExchange's Proposed Findings of Fact, Section XIII.D. Those findings show that Dr. Kendall's study is beyond salvation. Two errors are particularly egregious: *First*, an idiosyncrasy in the way [redacted] collects data means that it *over estimated* time listening to Apps (predominantly Spotify) as compared to websites (predominantly Pandora). As an unsurprising result of the fact that the App data were tracked for *all the time that the App was left open*, Dr. Kendall found that machines in his study listened to interactive services 18 times longer duration than non-interactive services. *See* Hr'g Tr. 3273:9-25 (May 12, 2015) (Kendall). This error infected and carried through his entire analysis, resulting in a conclusion that non-interactive services are 15 time *more promotional* than interactive services. *Second*, Dr. Kendall assumed that the data tracked listening time on Google Play, Apple iTunes Radio, and Amazon, but the very websites tracked by [redacted] are *not* websites from which one can access the music streaming services. Hr'g Tr. 3321:24-3322:3 (May 12, 2015) (Kendall).

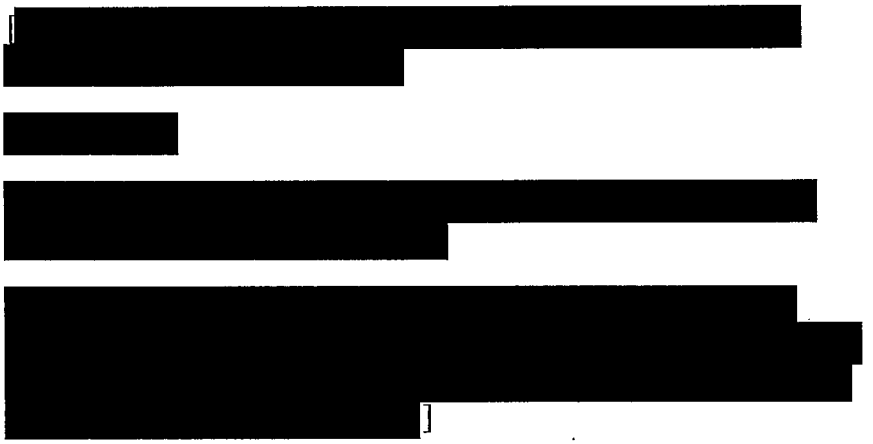
1. Recognizing the major flaws in Dr. Kendall's analysis, the Services (particularly iHeart) turn to Dr. Blackburn's analysis of the data that Prof. Danaher had used before he was withdrawn as an expert, as discussed above. Dr. Blackburn analyzed the same data and arrived at the same results that iHeart *withdrew* because it did not achieve statistically significant results and did not support a finding that non-interactive and interactive services are different in their

promotional and substitutional effect. iHeart opposed the admission of (or even discovery into) Dr. Danaher's results, seeking to withdraw it from consideration and distance itself from the results that support SoundExchange's case. Now, confronted with those results, it disingenuously makes a fallback argument that the very same results really do support its case. It should not be overlooked that iHeart would not stand behind the same argument when made by its own expert.

165. Dr. Blackburn looked at "discovery events" that were a "yes or no" rather than a duration of time spent listening as Dr. Kendall did. Hr'g Ex. SX-24 ¶ 40 (Blackburn WRT). His experiment, therefore, is not similarly flawed. Nonetheless, as Dr. Blackburn explained, the very nature of an experiment like this biases the results toward finding *promotion.* Still, Dr. Blackburn found *no* statistically significant difference between the promotional and substitutional effect of interactive and non-interactive services. *Id.* ¶ 39. Dr. Blackburn also found that the promotional or substitutional effect on digital download purchases made on a desktop of using either a non-interactive or interactive service (again, on a desktop) could not be distinguished from zero. *Id.* ¶ 42. iHeart only relies on the test which Dr. Blackburn explains is *not* appropriate because it excludes machines with no purchases. This is wrong as Dr. Blackburn explains. Hr'g Ex. SX-24 at 28 n.52 (Blackburn WRT) (describing the set of regressions that exclude all data with zero sales both before and after "discovery" as "inappropriate").

166. Finally, internal record company documents counter the Services' claims that non-interactive streaming is more promotional than interactive streaming and even point in the opposite direction. For example, SoundExchange Exhibit 2077, pictured above, show that [redacted]. Prof. Katz further admitted that on a

user-by-user basis, his conclusion from this document was that [ ]:



Hr'g Tr. 3058:11-21 (May 11, 2015) (Katz).

c. Services' "diversionary promotion" arguments are wrong as a matter of law, economics, and logic

167. Citing Prof. Katz's hearing testimony, the Services argue that diversionary, rather than expansionary, promotion is relevant to negotiating direct licenses and is therefore the inquiry relevant to § 114(f)(2)(B)(ii). Pandora PFOF ¶ 407; NAB PFOF ¶ 398.

168. As explained more fully in SoundExchange's Reply Conclusions of Law § II.B.1, the Services' argument that § 114(f)(2)(B)(ii) addresses diversionary promotion and therefore the Judges should accept any purported promotional benefit to a single record label as evidence of a lower rate under the statute is wrong as a matter of statutory interpretation. *See, e.g.,* iHeart COL § III, ¶¶ 15-19.

169. As an economic matter, diversionary promotion means that any promotional benefit to one label is offset by a substitutional cost to another. But, even if there were some promotional benefits to those "steered" labels, setting a lower rate would be flawed economic logic. The hypothetical promotional benefits are offset by hypothetical substitutional costs—so

any adjustment to the statutory rate would have to account for the negative impact (and corresponding higher rate) to labels that were steered against.

170. Furthermore, Pandora's claim that diversionary promotion would be *more relevant* than expansionary promotion or substitution to any *particular* label is simply a back-door steering argument and unpersuasive for the same reasons. *See* discussion of steering in Section IV.E *infra.*

4. NAB's And iHeartMedia's Characterizations Of The Purported Lack Of Profitability Of Webcasters Are Irrelevant And Unfounded

171. The Services contend that the Judges should adopt lower rates because these services are currently unprofitable. *See* IHM PFOF at i–ii, ¶¶ 33–44; NAB PFOF ¶¶ 119–32. iHeartMedia claims that it "loses money at the current high rates ($0.0025) and has never turned a profit on webcasting," IHM PFOF at i, and that its webcasting business "is not profitable on a standalone basis" *Id.* ¶ 14. Similarly, the NAB relies on testimony from certain select broadcasters to argue that simulcast is unprofitable. NAB PFOF ¶¶ 119–32. Relying on this purported lack of profitability, the Services urge the Judges to "reset" the statutory rates. NAB PFOF ¶ 4; IHM PFOF at i.

172. The Services' "profit-based" approach to rate setting is at odds with the statutory standard and the underlying facts. Congress has made clear, and the Judges have consistently recognized, that the goal of rate setting under § 112 and § 114 is not to ensure a profit for any webcaster or set of webcasters. 17 U.S.C. §§ 112(e)(4), 114(f)(2)(B); *Web III Remand*, 79 Fed. Reg. 23102, 23112 (April 25, 2014); *Web II*, 72 Fed. Reg. 24084, 24088 n.8 (May 1, 2007). Rather, the Judges must "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). As the evidence in this proceeding demonstrates, there is a

fundamental disconnect between this marketplace standard and the Services' preferred profit-based approach.

173. Moreover, even if profitability were a relevant factor, the Services' profit-based approach is fatally flawed. Prof. Lys testified that an approach that focuses on *current* and *standalone* profitability has no economic basis. Hr'g Ex. SX-28 ¶¶ 102–07, 134 (Lys WRT). As the evidence, including Prof. Rysman's and Prof. Lys's testimonies, show, the Services' myopic approach ignores the long term value generated by webcasting and the tradeoffs that the Services have made to focus on growth and future profits at the expense of current profits. This approach also does not account for the value that webcasting can generate for other aspects of a company's business.

a. Webcaster Profitability Is Not A Relevant Factor Under The Statutory Standard

174. The applicable statutory standard directs the Judges to adopt a market rate—the Judges must "establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B). The Judges' determination should also account for whether the use of a service might substitute for, promote, or otherwise affect the *copyright owners*' streams of revenues and the relative contributions of the owners and licensees in making the licensed work available to the public. *Id.* Notably, nothing in the statutory language directs or permits the Judges to take account of the Services' profitability. And nothing in the statutory language directs the Judges to ensure that the Services can make a profit based on their current business models or product offerings.

175. By contrast, in other contexts in the same and in related statutes, Congress has expressly and specifically accounted for the financial condition of services or broadcasters. For

example, the same subsection of the same statute that governs the statutory license at issue in this proceeding also creates a statutory license for the performance of sound recordings by preexisting subscription services and preexisting satellite services. 17 U.S.C. § 114(f)(1)(B). But, as the Judges are well aware, unlike the statutory license for webcasting, the statutory license for pre-existing services directs the Judges to account for the financial condition of the services. *Id.* § 801(b)(1) (directing the Judges to account for the following objectives: "to afford . . . the copyright user a fair income under existing economic conditions" and to "minimize any disruptive impact on the structure of the industries involved and on generally prevailing industry practices"). Similarly, many other statutory licenses direct the Judges to take the services' financial condition into account. *Id.* (directing the Judges to apply the § 801(b)(1) factors in numerous proceedings).

176. In sum, there can be no doubt that Congress knows how to direct the Judges to take account of webcaster profitability. Yet, instead of directing the Judges to apply the § 801(b)(1) factors in the context of webcasting, Congress elected to apply a market-based standard to webcasting that makes no mention of webcaster profitability.

177. The Librarian of Congress and the Judges have repeatedly recognized that the willing buyer/willing seller standard does not take account of webcaster profitability. In *Web I*, the Librarian of Congress explained that the statutory standard does not provide for consideration of "the financial health of any particular service." *Web I*, 67 Fed. Reg. at 45254 . Rather, the Judges need only confirm that that the "benchmarks [they] adopt [are] indicative of marketplace rates." *Id.* The Librarian explained:

> Where the intent of Congress is to set a rate at fair market value, as in this proceeding, the Panel is not required to consider potential failure of those businesses that cannot compete in the marketplace. *See National Cable Television Ass'n. v. CRT*, 724 F.2d 176 (D.C.

> Cir. 1983) (holding that rates set at fair market value were proper even though cable operators argued that the rates were prohibitively high and would cause them to cease transmission of the distant signals at issue.).

Id.

178. Similarly, in *Web I*, the Librarian rejected the argument that "that the rates set by the [Copyright Arbitration] Panel thwart Congressional intent by making Internet performances of sound recordings economically unviable for many webcasters." *Web I*, 67 Fed. Reg. at 45254 (internal quotation marks omitted). The Librarian noted that, given the industry's orientation towards growth, "a proposed fee that results in royalty payments above the current revenue stream for a webcaster is not atypical or unexpected." *Id.*

179. Subsequently, in *Web II*, the Judges noted that taking account of webcaster profitability in setting the statutory rate "would involve the Copyright Royalty Judges in making a policy decision rather than applying the willing buyer/willing seller standard of the Copyright Act." *Web II*, 72 Fed. Reg. at 24088 n.8.

180. More recently, in the *Web III Remand* decision, the Judges re-affirmed that the statutory standard "does not provide for a consideration of the financial health of any particular service when establishing rates." *Web III Remand*, 79 Fed. Reg. at 23112 (citations and internal quotation marks omitted). Similarly, the Judges also held that "[t]he Act instructs the Judges to use the willing buyer/willing seller construct, assuming no statutory license." *Id.* at 23107. "The Judges are not to identify the buyers' reasonable other (non-royalty) costs and decide upon a level of return (normal profit) sufficient to attract capital to the buyers." *Id.* And the Judges explained that "the fact that any particular number of webcasters might not profit under [the established rate], or that others would either shut down or never enter the market, is not evidence that the rate deviates from the market rate." *Id.* at 23119.

181. Despite the statute's clear language and the Librarian's and Judges' repeated rejection of a profit-based approach to rate-setting, the Services once again press the argument that the Judges should take their profitability into account. Once again, the Judges should reject this invitation to "mak[e] a policy decision rather than apply[] the willing buyer/willing seller standard of the Copyright Act." *Web II*, 72 Fed. Reg. at 24088 n.8.[13]

b. The Evidence Shows The Fundamental Disconnect Between Profitability And The Willing Buyer/Willing Seller Standard.

182. The evidence presented in this case, and described in detailed in SoundExchange's Proposed Findings of Fact, demonstrates that "the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller . . . cannot be discovered by studying the current or short-term profitability (or unprofitability) of any webcaster or of the webcasting industry." SX PFOF ¶ 1188 (citation omitted). The Services have not rebutted or responded to this evidence.

183. SoundExchange's evidence includes the testimony of Prof. Lys, who noted that "[f]rom the standpoint of economics, a company's ability to pay royalties while still remaining profitable and the 'willing buyer/willing seller' standard are two very distinct concepts." Hr'g Ex. SX-28 ¶ 103 (Lys WRT). Prof. Lys explained that "[a] company's 'ability to pay,' while still remaining profitable in the short term, is a static analysis driven by that firm's observed financial performance." *Id.* "By contrast," according to Prof. Lys, "the price that would be set between a willing buyer and a willing seller represents a dynamic market-based determination." *Id.*

[13] The NAB goes further and asks the Judges to take into account "the valuable public services" purportedly provided by its members. NAB PFOF ¶ 142. The willing buyer–willing seller standard does not encompass these policy preferences.

184. Prof. Lys provided additional testimony that demonstrated the disconnect between market-based pricing and webcaster profitability. *See* SX PFOF ¶ 1189–92. In particular, he noted that the prices of "other cost inputs, whose levels are also determined in the marketplace, are agnostic as to the financial position of the buyer." Hr'g Ex. SX-28 ¶ 106 (Lys WRT). For example, "in an open market, a webcaster could not seek lower prices for servers or for network bandwidth based on its current profitability." *Id.* This testimony is undisputed.

185. SoundExchange's Proposed Findings of Fact also discuss the testimony of Pandora's Chief Financial Officer, Michael Herring, who recognized that the willing buyer/willing seller standard does not take account of a webcaster's ability to pay. SX PFOF ¶ 1193. As Mr. Herring noted:

> The Judges are not, as I understand it, tasked with determining the rate any particular party theoretically could pay and remain in business. The rate that Pandora is theoretically *capable* of paying is simply not informative to the Judges of the rates at which Pandora would be a 'willing buyer' of statutory sound recording performance rights.

Hr'g Ex. PAN 5016 ¶ 4 (Herring AWRT).

186. Moreover, in their Findings, the Services do not provide any evidence that record companies, as willing sellers, would willingly accept lower rates on account of a webcaster's lack of profitability. *C.f. Web III Remand*, 79 Fed. Reg. at 23107 ("Dr. Fratrik does not provide any evidentiary support for the assumption that the record companies, i.e., the willing sellers in the hypothetical marketplace, would accept (or be compelled to accept) a royalty rate simply because it allowed buyers to realize a predetermined level of revenue as profits."). Without any such evidence, there is no reason to assume that willing sellers would lower their rates to ensure that webcasters achieved profitability. To the contrary, as Prof. Lys testified, the sellers of other

inputs are generally agnostic to the financial health of the buyers. Hr'g Ex. SX-28 ¶ 106 (Lys WRT).

c. iHeartMedia And NAB Incorrectly Focus On The Current Profitability Of Webcasters

187. In any event, even if webcaster profitability were relevant under the statutory standard, both the NAB and iHeartMedia incorrectly focus on the *current* profitability of webcasters. Notably, Pandora does not argue in its Proposed Findings of Fact that the Judges should take its short term financial condition into account.

188. In its Proposed Findings of Fact, SoundExchange discussed in detail the evidence that demonstrates why focusing on current and short-term profitability is misleading. SX PFOF ¶¶ 1194–1208. In particular, "[u]ndisputed evidence establishes that webcasters, like many firms, face a tradeoff between current profits and future profits." SX PFOF ¶ 1194. This evidence includes testimony by economists from both sides, including Prof. Rysman, Dr. Peterson, Prof. Katz, Prof. Lys, and Dr. Blackburn. For instance, Dr. Peterson, a witness for Pandora and NAB, testified: "[w]hen actions today affect profitability in the future, firms may not maximize profits in the current period because doing so is too costly in terms of future profits." Hr'g Ex. NAB 4013 ¶ 75 (Peterson Corr. WRT). Prof. Katz acknowledged the same principle: "If you are asking me, is it rational strategy for Internet firms to potentially run losses in the short run while they're building bases in the future, the answer is yes." Hr'g Tr. 3117:9-12 (May 12, 2015) (Katz).

189. SoundExchange's Proposed Findings of Fact also summarize evidence presented by Prof. Rysman and Prof. Lys that "'[b]ased on the observed behavior of certain webcasters as well as their public statements . . . certain firms in [this] industry have in fact engaged in high-growth strategies that focus on future profits and growth at the expense of current profits.'" SX

PFOF ¶¶ 1198–1204 (quoting Hr'g Ex. SX-18 ¶ 9 (Rysman WRT)). For instance, Prof. Rysman quoted an internal strategy presentation that described iHeartMedia's webcasting strategy as follows: [redacted] Hr'g Ex. SX-18 ¶ 79 (Rysman WRT) (quoting Hr'g Ex. SX-166 at 11). As Prof. Rysman noted, iHeartMedia has followed through on this [redacted] by offering its listeners a customized radio service that is similar to Pandora but that does not have commercial interruptions. *Id.* ¶ 80. This evidence of iHeartMedia's strategy is undisputed.

190. Having voluntarily chosen a [redacted] to [redacted], it is particularly inappropriate for iHeartMedia to now ask the Judges to take its self-imposed lack of profitability into account in this rate-setting proceeding.

191. Similarly, Prof. Lys relied on public statements by Pandora and other information to conclude that "Pandora made a voluntary decision to adopt a business strategy aimed at rapid growth." Hr'g Ex. SX-28 ¶¶ 19-25 (Lys WRT); SX PFOF ¶¶ 1203–04.

192. SoundExchange's Proposed Findings of Fact also discuss evidence showing that simulcasters are focused on future profits. SX PFOF ¶¶ 1205–06. As one example, Lincoln Financial Media Company's [redacted] Hr'g Ex. SX-1579 at 7. And, Mr. Dimick of Lincoln Financial Media Company testified that his company streams in the hopes of generating *future* profits:

> Q. What's the economic incentive to do that for eight years? If you're losing money chronically, you're certainly not making it up on volume.

> A. No, no. Really it's, you know, kind of – one of the things that we do is try to skate to where the puck is going to be.
>
> And so, you know, trying to be in all places, the same with HD, is to have our services there where listeners might find us.
>
> So – because they start moving over to streams, you know, we want to be there like everybody else, like our competitors.
>
> . . . .
>
> Q. And you're hoping that loss gets offset down the road when the market finally takes off?
>
> A. Yes, sir.

Hr'g Tr. 5836:13 – 5838:24 (May 26, 2015) (Dimick).

193. In effect, simulcasters like Lincoln Financial have voluntarily chosen to accept a potential short term loss in order to "skate to where the puck is going to be" and recoup their investments in the long term. Because these simulcasters have made that choice, "a proposed fee that results in royalty payments above [their] current revenue stream . . . is not atypical or unexpected." *Web I*, 67 Fed. Reg. at 45254.

194. Prof. Rysman explained why this behavior—focusing on future profits at the expense of current profits—is rational in the context of webcasting. Hr'g Ex. SX-18 ¶¶ 50-76, 86 (Rysman WRT). The webcasting industry exhibits certain features that favor scale and market leadership, including network effects, economies of scale, and seller learning. *Id.* ¶ 86. Given these factors, it is economically rational for a webcaster to adopt a strategy focusing on long-run profitability at the expense of short-run profits. *Id.*

195. Thus, even if webcaster profits were a relevant factor under the statutory standard "a rate setting approach that focuses on current profits ignores a fundamental feature of the webcasting industry—the fact that industry participants are oriented towards growth, market

leadership, and future profits and not towards short-term profitability." Hr'g Ex. SX-18 ¶¶ 10, 87 (Rysman WRT).

d. iHeartMedia And The NAB Incorrectly Focus On The Standalone Profitability Of Webcasters

196. In addition to their shortsighted focus on current profitability, iHeartMedia and the NAB also incorrectly focus on the standalone profitability of webcasting. For instance, iHeartMedia admits that Apple, Amazon, and Google have the ability to operate music services by supporting these services with profits from other lines of business. IHM PFOF ¶ 53. Yet, relying on David Pakman's testimony, iHeartMedia claims that "[i]t is a sign of an unhealthy market if the only digital music companies are those owned by large companies . . . ." *Id.* (citation omitted). Similarly, the NAB compares only "direct streaming expenses" with "direct streaming revenues" for Lincoln Financial Media Company to conclude that streaming is unprofitable for Lincoln Financial Media Company. NAB PFOF ¶ 123.

197. The evidence shows, however, that even if profitability were a relevant factor under the statutory standard, it would be misleading to consider standalone profitability.

198. SoundExchange addressed the Services' focus on standalone profitability in its Proposed Findings of Fact. SX PFOF ¶ 1209–16. In sum, there is no economic justification for the Services' focus on standalone profitability and no support for Mr. Pakman's claim that it would be "unhealthy" for the industry if streaming services were offered exclusively by companies with multiple lines of business.

199. In *Web III*, the Judges rejected Dr. Fratrik's analysis of Live365's webcasting costs because Dr. Fratrik failed to "address the *synergistic* nature of Live365's various lines of business." *Web III*, 79 Fed. Reg. at 23108 (emphasis added). Similarly, in this proceeding the Services continue to ignore the synergistic effect of multiple lines of business.

200. As Prof. Lys noted, focusing on standalone profitability "fails to account for the value music brings to . . . companies' larger platforms." Hr'g Ex. SX-28 ¶ 134 (Lys WRT). Prof. Lys noted that companies may operate break-even or unprofitable digital music services to support other aspects of their business. *Id.* This suggests that these companies "value music's contribution to their platforms in an amount *greater than* the royalty rates." *Id.* Similarly, Prof. Rysman explained how including streaming in a larger portfolio of businesses can lead to synergistic effects. SX PFOF ¶ 1211; Hr'g Ex. SX-18 ¶ 47 (Rysman WRT).

201. The Services have not offered any evidence to contradict Prof. Lys's and Prof. Rysman's testimony regarding the synergistic effects of including streaming as one component among multiple lines of business. Rather, the evidence offered by the Services confirms that, when viewed holistically, webcasting offers significant benefits to businesses—benefits that are ignored by a standalone model of profitability.

202. For instance, Mr. Pakman testified that large companies are willing to "subsidize" streaming "*in order to make profit elsewhere* on other related businesses." Hr'g Ex. IHM 3216 ¶ 28 (Pakman WDT) (emphasis added). In other words, large companies engage in streaming because it creates benefits for them across their other lines of business. Mr. Pakman expressly agreed with this characterization during the hearing:

> Q. You refer to it as subsidizing the poor economics, but another spin on that certainly would be that they're willing to invest in the noninteractive space, right, in order to get greater returns on other lines of business that they have so it becomes a net positive return on investment or so they would project, which is why they go into it. Isn't that just another form of investment?
>
> A. I believe that their willingness to operate unprofitable businesses is because it provides them some benefit in some other part of their company for sure.

Hr'g Tr. 6242:8-20 (May 27, 2015) (Pakman).

203. Similarly, the NAB's characterization of Lincoln Financial Media Company's finances ignores the overall value created by streaming. As Prof. Lys noted:

> [T]he testimonies [of NAB witnesses] indicate that the profitability of terrestrial radio's simulcasting activities should not be considered on a "stand-alone" basis. The NAB's witnesses appear to be ignoring the full value being created by streaming sound recordings. For example, John Dimick, a witness for Lincoln Financial Media Company ("LFMC") noted that "[p]art of the value we provide as a broadcaster is enabling our listeners to hear our programming in the car, at work, in their home, and wherever else they may be." Yet these benefits are not accounted for in Mr. Dimick's computations.

Hr'g Ex. SX-28 ¶ 218 (Lys WRT) (quoting Hr'g Ex. NAB 4002 ¶ 14 (Dimick WDT)).

204. Mr. Dimick reported financial numbers for certain Lincoln stations that appeared to indicate that those stations were streaming at a loss. Hr'g Ex. NAB 4002 ¶ 27 (Dimick WDT). For 2014, [ ] *Id.* However, Mr. Dimick admitted that although Lincoln's simulcast listeners hear the same commercials as Lincoln's terrestrial listeners, the financial numbers he provided did not include *any* of the revenue earned from such commercials. Hr'g Tr. 5863:10–5864:2 (May 26, 2015) (Dimick). This is despite the fact that roughly 1% to 2% of Lincoln Financial's listeners actually come from its simulcast service. *Id.* at 5864:20–5865:5.

205. By way of example, Mr. Dimick estimated that Lincoln Financial's revenues in 2014 were approximately Hr'g Tr. 5874:22–5875:3 (May 26, 2015) (Dimick). Given that Mr. Dimick reported streaming losses in [,] if even just one percent of this were allocated to streaming, it would materially alter the financial numbers reported by Mr. Dimick.

e. Content Owners Need Not Subsidize Simulcasters' Inefficient Business Models

206. The NAB complains that simulcasters are unable to generate adequate revenue from webcasting to offset their costs. As SoundExchange demonstrated in Section II.B.4.c, *supra*, this claim incorrectly focuses on standalone and current profitability. But, in addition, the evidence shows that simulcasters' inability to generate revenue is due to their failure to adopt efficient and competitive business models.

207. There is significant evidence in the record that targeted advertising enables internet firms to command higher advertising premiums. According to Mr. Herring, Pandora's CFO:

> Because we collect a listener's age, gender, and zip code at registration, we know these basic demographic facts about our audience. If an advertiser requested, we can, for example, target women aged 25-35 in New York with a particular advertisement. This ability to target specific audiences enables us to attract advertising, as well as obtain higher rates for those ads, because advertisers know that their ads are being delivered to those listeners that are most likely to be consumers of their products.

Hr'g Ex. PAN 5016 ¶ 31 (Herring AWRT).

208. Similarly, Prof. Rysman testified that "[s]eller learning is particularly valuable to advertising-based services." Hr'g Ex. SX-18 ¶ 27 (Rysman WRT). "Advertisers often value the ability to show advertisements to consumers who are most likely to be interested." *Id.*

209. Despite the demonstrated value of targeted advertising, the simulcasters in this proceeding do not employ this tool. Mr. Downs of Bryan Broadcasting testified that Bryan has a "policy" to not collect the information required for targeted advertising. Hr'g Tr. 5243:22–5244:3 (May 21, 2015) (Downs). He noted: "We don't treat our listeners as prey. So we don't try to gather up any sort extraneous information." *Id.* Whatever the virtues of this business decision, the consequences—a reduction in revenue and profit—do not justify the NAB's request for a lower rate under the willing buyer/willing seller standard.

210. Similarly, Mr. Downs testified that one of the reasons advertisers are not willing to pay as much for Bryan's advertising is because Bryan's simulcast transmissions reach out-of-market listeners: "Why would someone from Chicago, for example, be interested in a special at local restaurant? Yet I am required to pay SoundExchange royalties for both local and non-local listeners who I simply cannot monetize." Hr'g Ex. NAB 4005 ¶ 22 (Downs). Of course, Mr. Downs has the option of geo-fencing his stations to prevent out-of-market listeners from tuning in. *See* Hr'g Tr. 5846:12–18 (May 26, 2015) (NAB witness, Mr. Dimick, acknowledging the possibility of geo-fencing).

211. Likewise, Mr. Dimick of Lincoln Financial testified that he is not trying to build "a national audience" with Lincoln's stations. Hr'g Tr. 5845:5– 5846:17 (May 26, 2015) (Dimick). Yet Mr. Dimick has geo-fenced only one of his company's numerous stations. When asked why he had not geo-fenced the other stations, he noted that offering out of market listeners access to his stations "is kind of a service that we like to offer." *Id.* at 5846:5–11. Again, regardless of the virtues of Mr. Dimick's and Mr. Downs's business decisions, copyright owners should not be asked to bear the costs in the form of lower royalty rates.

212. Moreover, the evidence indicates that simulcasting in its current form is an inefficient business model. As the Judges have previously explained:

> [T]he Copyright Royalty Judges cannot guarantee a profitable business to every market entrant. Indeed, the normal free market processes typically weed out those entities that have poor business models or are inefficient. To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating copyright owners on the same basis as more efficient market participants trivializes the property rights of copyright owners.

Web II, 72 Fed. Reg. at 24088 n.8

213. Although the undisputed evidence demonstrates that webcasting is an attractive product to consumers, simulcasters have failed to gain traction with consumers. Over the last rate period Pandora has grown from streaming approximately seven billion listener hours in 2011 to streaming over twenty billion listener hours in 2014. Hr'g Ex. SX-28 ¶¶ 45–56 (Lys WRT). As of December 2014, Pandora had over 81 million active users. Hr'g Ex. SX-158 at 6. iHeartMedia agrees that "[w]ebcasting has many appealing features for consumers that are not available on, or improve upon, the features on terrestrial radio and other traditional methods of music listening," such as improved sound quality. IHM PFOF ¶ 26.

214. Despite the popularity and attractiveness of webcasting, consumers remain uninterested in simulcasting—though not for lack of options. For example, Mr. Dimick testified that his stations have been simulcasting for years, yet only approximately 1% of his stations' listeners are streamers. Hr'g Tr. 5864:20–5865:5 (May 26, 2015) (Dimick). Similarly, despite the fact that his stations have also been streaming for years, Mr. Downs testified that advertisers don't see value in his stations' simulcast streams. Hr'g Tr. 5242:6-12 (May 21, 2015) (Downs).

215. As SoundExchange discusses, Section VI, *infra*, simulcasters have started to innovate by taking advantage of search technology, aggregators, and other technology. To adopt a rate that subsidizes simulcasters' inefficient business models would simply undercut any incentive to innovate.

f. The NAB's Claim That The Current Rates Have "Throttled" The Growth Of Simulcasting Is Inaccurate

216. The NAB relies on charts prepared by Dr. Peterson and on other reporting data to argue that the "lack of significant growth in performances by webcasters or simulcasters paying at or near the CRB-set commercial rates confirms the unhealthy state of the simulcasting market." NAB PFOF ¶¶ 144 – 148. NAB's interpretation of this data is inaccurate.

217. First, NAB's own witness, Dr. Peterson, who prepared the charts that NAB relies on, testified that this type of analysis cannot reveal whether rates are too high or too low. As Dr. Peterson noted regarding the identical analysis performed by Dr. Blackburn: "I don't find that analysis to be informative at all, because what it shows is that there is some entry and that Webcasters enter and survive for some period of time, but that would be the case whether rates . . . were set at monopoly levels or were set at competitive levels." Hr'g Tr. 3877:1-8 (May 14, 2015) (Peterson).

218. Second, what this data *does* show is that broadcaster performances have grown every year from 2010 to 2013. NAB PFOF ¶ 146. In 2010, broadcaster performances were [redacted] and as of 2013 performances had increased to [redacted]. This represents [redacted] growth over four years, and does not support the claim that simulcaster growth has been "throttled." Rather, it indicates that the simulcasters in the market are willing buyers at the NAB rate for [redacted] performances.[14]

219. The NAB also claims that broadcaster royalties have declined as a percentage of total webcasting royalties over the last rate period. NAB PFOF ¶ 146. The relevance of this claim is unclear. The fact that consumers have expressed a preference for forms of webcasting other than simulcasting does not indicate that the rate for simulcasting is too high.

g. David Pakman's Testimony Does Not Support The NAB's And iHeartMedia's Cases

[14] The NAB's chart also shows broadcaster performances for 2014. Although the chart *appears* to show a decline in performances for 2014, NAB is careful not to make such a claim. NAB PFOF ¶ 146. Instead, the NAB claims only that broadcaster royalties have declined as a percentage of total royalties. The NAB correctly does not claim that performances have declined in 2014 because it is aware from SoundExchange's production of the underlying document that the data is incomplete for 2014.

i. *Mr. Pakman's testimony cuts against NAB and iHeartMedia*

220. Because Mr. Pakman's testimony does not distinguish between statutory webcasters and other digital music services, his testimony regarding "high" royalty rates actually cuts *against* the NAB and iHeartMedia.

221. As Prof. Lys noted, "Mr. Pakman's testimony does not distinguish between statutory webcasters and other digital music services." Hr'g Ex. SX-28 ¶ 109 (Lys WRT). For example, "Mr. Pakman testified [that] Venrock, one of the oldest venture capital firms in the world, 'has never invested in *any digital music* or internet radio companies,' and 'the overwhelming majority of [his] venture capital colleagues have taken a similar approach." NAB PFOF ¶ 155 (emphasis added) (quoting Hr'g Ex. IHM 3216 ¶ 29 (Pakman WDT)). Similarly, Mr. Pakman frequently uses interactive and directly licensed services as examples of companies paying "high royalty rates." *See* Hr'g Ex. IHM 3216 ¶ 22 (discussing MusicBank, a company that "negotiated deals with all the major labels"), ¶ 19 n.4 (discussing Spotify and Rhapsody). And in performing his "Pitchbook" analysis, Mr. Pakman included all digital music companies, not just webcasters. *Id.* ¶ 26 & n.32; Hr'g Tr. 6228:20-22 (May 27, 2015) (Pakman) ("[T]he 175 that I identified are digital music venture-backed companies. They're not all webcasters.").

222. Prof. Lys testified that "[b]y arguing that *all* digital music services are currently unprofitable or face unattractive gross margins, Mr. Pakman implicitly accepts that buyers outside the sphere of the statutory rate are willing to accept royalty rates that do not guarantee or generate current profits." Hr'g Ex. SX-28 ¶ 109 (Lys WRT). Prof. Lys continued: "if Mr. Pakman is correct about the 'high' royalty rates faced by the overall digital music industry, his testimony suggests that low statutory rates would provide statutory webcasters with a subsidy that they would not be able to obtain the market." *Id.* ¶ 110. In other words, Mr. Pakman's

testimony confirms that, in the absence of a statutory license, willing buyers and willing sellers would negotiate "high" rates, even if such rates would lead to currently unprofitable webcasters.

ii. *Mr. Pakman's testimony is at odds with the statutory standard*

223. Mr. Pakman's testimony is also at odds with the willing buyer/willing seller standard. Indeed, Mr. Pakman's testimony makes clear that he believes that the statutory license should provide companies with subsidized access to music. For example, Mr. Pakman testified that, when Congress enacted the DMCA he "heralded" it as a major accomplishment because it would obviate the need for "costly and hard to negotiate voluntary licenses." Hr'g Ex. IHM 3216 ¶ 17. Similarly, he notes that although "[i]t would be possible for the labels and publishers to set rates in such a way as to allow licensees to experience healthier and sustainable gross margins," "the record labels have *chosen not to do this*." *Id.* ¶ 30 (emphasis added). Mr. Pakman recognizes that, left to their own devices, record labels would not willingly accept the low-cost licenses he advocates. He openly views the statutory license as a tool to set rates that record labels would not voluntarily agree to. The statutory standard leaves no room for Mr. Pakman's policy preferences.

iii. *Mr. Pakman's analysis of venture capital investments is irrelevant*

224. Mr. Pakman's analysis of the investments in webcasting is unduly narrow and is confined to only one type of investment—investments by venture capital firms. Prof. Lys explained that it was incorrect for Mr. Pakman to focus solely on venture capital investments and to discount investments by other entities. Hr'g Ex. SX-28 ¶ 141 (Lys WRT).

225. It is clear that Mr. Pakman failed to consider non-venture capital investments. Initially, Mr. Pakman acknowledged that he was "not sure" whether other entities, other than venture capital firms, were investing in webcasting. Hr'g Tr. 6239:17-21 (May 27, 2015)

(Pakman). He later admitted that Apple bought LaLa in 2009, developed and launched the iTunes Radio service in 2013, bought Beats in 2014, was preparing to re-launch Beats in 2015, that Google has a streaming music service, and that Amazon also provides a streaming service. *Id.* at 6239:17–6241:6. Mr. Pakman's testimony ignores these investments without justification.

226. Even with respect to venture capital investments, Mr. Pakman narrowly defined "success" to exclude investments that he unilaterally deemed insufficiently large. For instance, Mr. Pakman characterized Google's acquisition of Songza for $15 million as "not a successful outcome" even though it resulted in a 3:1 return on a $4 million investment. Hr'g Tr. 6236:7–21 (May 27, 2015) (Pakman).

iv. *Mr. Pakman's "Pitchbook" analysis has been discredited*

227. Mr. Pakman's "Pitchbook" analysis was thoroughly discredited by Prof. Lys and by the NAB's own witness, Dr. Peterson.

228. In performing his analysis, Mr. Pakman used a proprietary venture capital database to compare the failure rates of digital music companies to the failure rates for Software as a Service, Mobile Communications, and eCommerce firms. Hr'g Ex. IHM 3216 ¶ 26 (Pakman WDT). Looking at the 175 digital music companies in the database that were funded since 1997, Mr. Pakman concluded that the industry had experienced an 8.6% failure rate. *Id.* By contrast, the Software as a Service sector experienced a 4.2% failure rate, the eCommerce sector experienced a 6.5% failure rate, and the Mobile Communications sector experienced a 4.8% failure rate. *Id.*

229. Prof. Lys testified that objective measures of failure indicate that at least 25–30% of venture-backed businesses fail. Hr'g Ex. SX-28 ¶¶ 145–46 (Lys WRT). Viewed in that light, an 8.6% failure rate looks "downright enviable." *Id.* ¶ 146.

230. More significantly, Prof. Lys testified that Mr. Pakman's attempt to compare the failure rates of companies across sectors was misguided. Hr'g Ex. SX-28 ¶¶ 145–48 (Lys WRT). According to Prof. Lys "Mr. Pakman provides no evidence that the failure rates should be identical across industries." *Id.* ¶ 148. Similarly, Dr. Peterson, one of the NAB's own witnesses, agreed that it was not reasonable to compare the survival rates of webcasters to the survival rate of entities in the mobile communications space. Dr. Peterson agreed that "comparing [w]ebcaster survival rates to the survival rates of other industries doesn't provide us with any meaningful insights." Hr'g Tr. 3895:25–3896:4 (May 14, 2015) (Peterson). According to Dr. Peterson, "there would need to be an analysis" to support the claim that the industries are comparable. *Id.* at 3897:6–13. Because Mr. Pakman has not provided any such analysis, the Judges should reject his comparison.

5. The NAB's And iHeartMedia's Characterization Of The Purported Profitability Of Record Companies Is Irrelevant And Misleading

231. The Services claim that the record industry is highly profitable. For example, the NAB contends that "the record demonstrates unequivocally that the labels are highly profitable notwithstanding reduced revenues from physical and digital sales." NAB PFOF ¶ 166. Similarly, iHeartMedia claims that "the recorded music industry is thriving" and that the "major record labels [are] in excellent financial condition," IHM PFOF at 26, ¶ 63. And, according to iHeartMedia, record companies earn significantly higher margins from digital music as compared to physical sales. *Id.* at 26, ¶¶ 65–70. These claims regarding record company profitability are both irrelevant and misleading.

a. The Mere Fact That Certain Record Labels Are Profitable Is Irrelevant Under The Statutory Standard

232. Like their claims regarding *webcaster* profitability, the Services' claims regarding *record company* profitability are not tethered to the statutory standard. Because record labels are

for-profit companies, it is entirely unsurprising that they seek to make a profit. *Web I*, 67 Fed. Reg. 45240, 45245 (July 8, 2002) ("Sellers expect to make a profit and will extract from the market what they can, just as buyers will do everything in their power to get the product at the lowest possible price. These are the fundamental principles guiding marketplace negotiations."). The fact that certain record companies have successfully achieved a profit does not justify departing from marketplace rates. As even iHeartMedia recognizes, "'the standard for setting rates for nonsubscription services set forth in section 114(f)(2)(B) is strictly fair market value—willing buyer/willing seller'—and is not 'policy-driven.'" IHM COL ¶ 28 (quoting *Web I*, 67 Fed. Reg. 45240, 45245 (July 8, 2002)).

233. Although a record company's profitability (or unprofitability) is irrelevant under the statutory standard, this does not mean that any and all evidence regarding record company costs, investments, or business models, is also irrelevant.

234. The statute directs the Judges to consider content owners' "relative creative contribution, technological contribution, capital investment, cost, and risk." 17 U.S.C. 114(f)(2)(B). Accordingly, SoundExchange demonstrated in its Proposed Findings of Fact that record companies play a crucial role in bringing recorded music to market, bear substantial costs in getting sound recordings to the right audience, make considerable investments in developing and marketing artists, and endure significant risks. SX PFOF ¶¶ 165–216.

235. In particular, SoundExchange described the significant investments that record labels must make in developing and marketing artists. Mr. Harleston of Universal testified that Universal [ ] in recording costs and advances on a brand new artist before an album is ever released. Hr'g Ex. SX-9 ¶ 20 (Harleston WDT). In the case of an established artist, [ ] *Id.* ¶ 21.

236. Given these high costs, it is no surprise that in fiscal year 2013, [redacted].] Hr'g Ex. SX-9 ¶ 13 (Harleston WDT). Similarly, Sony [redacted]. Hr'g Ex. SX-12 at 5 (Kooker WDT); Hr'g Tr. 0356:1–0363:18 (Apr. 28, 2015) (Kooker).

237. By contrast, Pandora's total investment in its Music Genome Project is [redacted]. Hr'g Ex. PAN 5000 ¶ 30 (Westergren WDT). In other words, Sony's and Universal's annual investments in artist development far surpass Pandora's *aggregate* investment of [redacted] in its Music Genome Project.

238. The labels also invest significant sums in their digital distribution infrastructure. Since commercially viable digital services first emerged, Universal has invested [redacted] in IT infrastructure and operating costs and in professionals that distribute the thousands of digital files provided to hundreds of service partners every year. Hr'g Ex. SX-9 ¶ 32 (Harleston WDT). Similarly, Simon Wheeler testified that Beggars Group helped found Consolidated Independent, a leading provider of digital supply chain services to independent labels. Hr'g Ex. SX-21 ¶ 12 (Wheeler WDT). Mr. Wheeler explained that "[t]hese [supply chain] services do not come for free, and can cost an independent record label [redacted]." *Id.* ¶ 12. In addition to investments in artists and distribution, Beggars also invests in internal infrastructure costs and personnel costs. Hr'g Tr. 1209:14–1210:11 (Apr. 30, 2015) (Wheeler). This year alone, Beggars will invest over [redacted] in infrastructure. *Id.*

239. The above examples are just a small portion of the evidence in the record that shows the contributions that record labels make and the risks they endure to bring sound recordings to the market. *See* SX PFOF ¶¶ 165–216.

240. Second, the statute directs the Judges to consider "whether use of the service . . . may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings." 17 U.S.C. 114(f)(2)(B). SoundExchange presented substantial evidence that the emergence of digital streaming has caused a shift to an access model, in which record companies sell access to music, instead of a ownership model, in which record companies sell copies of albums. *See* Section II.B.1, *supra*. As SoundExchange's witnesses demonstrated, this shift means that it is increasingly important to record companies to ensure that streaming and other forms of distribution generate direct revenues. *See id.* When access to music is the final product, record companies cannot rely on purported promotional effects of distributing music. *See id.*

241. In sum, the services incorrectly focus on record company profitability. But the statutory standard does not consider whether record companies are profitable or unprofitable. The statute does, however, consider the costs, investments, and risks borne by record companies and described in SoundExchange's Proposed Findings of Fact.

b. The Services' Claims Regarding Record Company Profitability Are Misleading And Inaccurate

242. In any event, the Services' assertions regarding the record companies' profitability and success are misleading. Record companies have seen significant declines in revenue over the past decade. In 1999, $14.5 billion in recorded music was distributed in the United States. In 2013, the amount had dropped to just under $7 billion—a decline of 52% from 14 years earlier. Hr'g Ex. SX-12 at 8–9 (Kooker WDT). Nor have recent years seen a reversal of this historic decline. Instead, record industry revenue has remained flat or has decreased over the last rate period. Hr'g Ex. SX-3 ¶ 42 (Blackburn WDT). By contrast, Pandora's revenue increased from $233 million in 2011 to over $900 million in 2014. Hr'g Ex. EX-28 ¶ 49 (Lys

WRT). iHeartMedia's contention that record companies are "thriving" is simply not supported by the facts.

243. Similarly, iHeartMedia's claim that record companies earn dramatically higher margins on digital sales as compared to physical sales is misleading. First, iHeartMedia's discussion often conflates overall digital margin with the margin for webcasting. *See* IHM PFOF ¶ 65 (discussing Universal's digital margin); Hr'g Tr. 1355:4–11 (May 1, 2015) (Harleston) (testifying that "digital downloads" would be included under "online" revenue for Universal). Demonstrating that other digital channels may be higher margin businesses, does nothing to support the conclusion that webcasting is also a higher margin business.

244. In addition, even when iHeartMedia *does* discuss the margin for webcasting, it fails to account for a key difference in how artist royalties affect physical margin and webcasting margin. In the case of physical sales and digital downloads, a record company receives revenue from its distributors and, from that revenue, pays artist royalties. These artist royalties are the single biggest line item that affects margin. [

] IHM PFOF ¶ 68.

245. By contrast, for statutory webcasting, artist royalties are paid directly to the artists through SoundExchange. *See* 17 U.S.C. § 114(g)(2). [

]. Pursuant to

the statutory license, nearly 50% of statutory royalties are paid directly to artists. *See* 17 U.S.C. § 114(g)(2). [redacted] IHM PFOF ¶ 68. This is why Mr. Kooker testified that iHeartMedia's attempt to compare physical margin to digital radio margin is an "apples to oranges" comparison. Hr'g Tr. 524:20–525:4 (Apr. 28, 2015) (Kooker). Unlike with physical royalties, webcasting royalties are already reduced by approximately 50% before they are recorded as revenue.

246. Finally, the NAB claims that [redacted] NAB PFOF ¶ 167. Of course, under Pandora's rate proposal (let alone NAB's significantly lower proposal) Pandora is projected to earn more than $800 million annually in EBITDA by 2019. Hr'g Ex. SX-28 ¶ 282 (Lys WRT).

III. SOUNDEXCHANGE'S RATE PROPOSAL MOST ACCURATELY REFLECTS THE RATES AND TERMS THAT WOULD BE NEGOTIATED BY WILLING BUYERS AND SELLERS ABSENT THE STATUTORY LICENSE

247. In this section, SoundExchange addresses the following issues: its rate proposal and the fact that it is undisputed in several respects; that the interactive service agreements are the best benchmarks, and why the Services' arguments to the contrary, including on effective competition, are without merit; the interactivity adjustment is proper; the greater-of structure is economically warranted and reveals market preferences; and corroborative and confirmatory benchmark evidence, including the Apple and Section III.E agreements.

A. SoundExchange's Rate Proposal Is Undisputed In Several Respects

1. The Section 112 License Should Be Bundled With The Section 114 License And Be Allocated 5% Of The Value Of The Bundled License

248. SoundExchange has proposed a bundled rate for both the Section 112 right and the Section 114 right, five percent of which shall be allocated as the Section 112 royalty for the making of ephemeral copies. No participant has contested this proposal. The NAB agrees with SoundExchange that "[t]here is no dispute between SoundExchange and NAB regarding how the royalties for the ephemeral recording statutory license specified in 17 U.S.C. § 112(e) should be set." NAB PFOF ¶ 226. Similarly, Pandora agrees that "[t]here is no dispute on this point." PAN PFOF ¶ 416.

2. The Minimum Fee Should Be Maintained At $500 Per Station Or Channel

249. SoundExchange proposes that all commercial webcasters pay an annual, nonrefundable minimum fee of $500.00 for each calendar year or part of a calendar year of the license period during which they are licensees, for each individual channel and each individual station (including any side channel maintained by a broadcaster that is a licensee) subject to an annual cap of $50,000.00 for a licensee with 100 or more channels or stations. For each licensee, the annual minimum fee shall constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). SX PFOF ¶ 1247.

250. Similarly, with respect to noncommercial webcasters, SoundExchange proposes that all licensees (as defined in 37 C.F.R. section 380.2 of the proposed regulations) that are noncommercial webcasters (as defined in the same) pay an annual, nonrefundable minimum fee of $500.00 for each calendar year or part of a calendar year of the license period during which they are licensees, for each individual channel and each individual station (including any side channel maintained by a broadcaster that is a licensee, if not covered by SoundExchange's proposed settlements with CBI and NPR). For each licensee, the annual minimum fee shall

constitute the minimum fees due under both 17 U.S.C. §§ 112(e)(4) and 114(f)(2)(B). SX PFOF ¶ 1248.

251. No party has submitted a rate proposal calling for a different amount for the minimum fee for either commercial or noncommercial webcasters.

3. SoundExchange Should Be Designated As The Sole Collective

252. SoundExchange proposes that it should be designated as the Sole Collective to collect and distribute royalties for the period 2016-2020. *Am. Proposed Rates and Terms of SoundExchange, Inc.* at 7–8 (Feb. 24, 2015).

253. The Judges "have concluded previously that designation of a single Collective is economically and administratively efficient." *Web. III Remand*, 79 Fed. Reg. at 23124; *see also Web. II Final Order*, 72 Fed Reg. at 24104 ("[S]election of a single Collective represents the most economically and administratively efficient system for collecting royalties under the blanket license framework created by the statutory licenses."). Furthermore, the D.C. Circuit has held that "in selecting SoundExchange as the sole collective, the Judges fulfilled Congress's expectation that they would designate a single entity to receive royalty payments from licensees." *Intercollegiate Broad. Sys., Inc. v. Copyright Royalty Bd.*, 574 F.3d 748, 771 (D.C. Cir. 2009).

254. The Judges have designated SoundExchange as that sole Collective where "[n]o party to [the] proceeding requested a different or additional Collective" and SoundExchange sought "to continue as the sole Collective for royalties paid by commercial and noncommercial webcasters under the licenses at issue in this proceeding." *Web. III Remand*, 79 Fed. Reg. at 23124. Those are the circumstances here: No party other than SoundExchange has requested to be selected as the Collective; no party has proposed multiple collectives; no party has opposed the designation of SoundExchange as the Collective; and SoundExchange has presented

evidence of its proven track record of administering the statutory licenses efficiently and in the best interests of royalty recipients. Accordingly, SoundExchange should be designated as the sole Collective for 2016-2020.

B. Interactive Service Agreements Are The Best Benchmark

1. The Services' "Effective Competition" Arguments Are Misplaced And Do Not Undermine The Interactive Service Agreements As A Benchmark

255. In this section, SoundExchange responds to the Services' arguments on effective competition. First, the Services have not demonstrated that the purported "monopoly" prices in interactive service agreements, constrained and reduced by downstream competition, differ from those rates that would emerge through effective competition. Second, the Services' response to the labels' substantive negotiations with interactive services ignores real, material concessions made by the labels. Third, the Services ignore that in the hypothetical market, the same bargaining dynamic purportedly created by the "must-have" status of the major labels' catalogs would persist. Finally, the Services' conclusory arguments regarding the interactive agreements' MFN clauses are without any evidentiary foundation.

a. The Services Have Not Demonstrated That The Purported "Monopoly" Prices In Interactive Services Agreements Differ From The Prices That Would Emerge Through "Effective Competition"

256. The Services' principal attack on the interactive agreements benchmark is that they do not satisfy a purported requirement of "effective" or "workable" competition. As discussed in SoundExchange's Conclusions of Law and its Reply Conclusions of Law, the willing buyer / willing seller standard as adopted by Congress does not impose any "effective" or "workable" competition requirement.

257. But to the extent there is such a standard, it is readily satisfied in the context of the interactive services agreements, and the Services' arguments to the contrary fail.

i. The Services' Argument Hinges Almost Entirely On A Theoretical Point Concerning The Complementary Nature Of The Major Labels' Catalog For Interactive Services.

258. Nowhere in the Services' various proposed findings of fact is there any empirical or quantitative analysis establishing that the interactive services space is not "effectively" or "workably" competitive. Rather, the Services' attack on the interactive service agreements rests almost exclusively on a point of economic *theory* – that because the "repertoires of the Majors are indeed necessary complements rather than substitutes for on-demand services and that each major record company can seek to maximize its price in its license dealings with such entities without regard for the impact on the market writ large," all rates from the interactive service agreements are "monopoly rates" and should be rejected wholesale. Pandora PFOF ¶ 213; *see also id.* ¶¶ 212-224; NAB PFOF ¶¶ 291-319; IHM PFOF ¶¶ 291-292.

259. As demonstrated in SoundExchange's Proposed Findings of Fact (SX PFOF ¶¶ 466-67), the Services, however, offer no evidence or analysis demonstrating how much, if at all, the rates from the interactive streaming market would have been lower in the presence of what they describe as "effective" or "workable" competition. And their experts acknowledge that downstream competition could result in rates that are the same or close to an effectively competitive rate. And as a matter of fact, the underlying proof here establishes that the rates from the interactive service agreements satisfy any workable or effective competition standard, whatever those phrases can be reasonably construed to mean.

260. Indeed, Prof. Katz acknowledged that he has no idea what the rates would be in the interactive service agreements if they *did* purportedly reflect effective competition. *See* Hr'g Tr. 2945:14-17 (May 11, 2015) (Katz) ("Q. You can't tell us what the rates would have been in

those agreements if they did reflect effective competition, correct? A. That's correct."). This is because the "concept of effective competition doesn't give you a precise number by itself," it is a "fuzzier concept." Hr'g Tr. 5660:16-21 (May 26, 2015) (Katz). Indeed, as Prof. Katz acknowledged, there is no "bright line that separates an effectively competitive market from a market that's not effectively competitive." Hr'g Tr. 2803:9-12 (May 11, 2015) (Katz) ("A. No, I don't believe there is.").

261. The Services *hypothesize* that the rates in the interactive service agreements might be lower with purported price competition between the labels, but this is ultimately a red herring. None of their experts can say what percentage, if any, the rates would be lower in the presence of price competition, and whether that rate would fall inside or outside of the "effective competition" line, given the broad spectrum of what even purportedly constitutes "effective competition." Their argument all comes down to the same repeated mantra: that given the complementary nature of the major labels' catalogs, the rates in the interactive service agreements are "monopoly" rates and must be rejected, without consideration of any other competitive forces in the interactive services space. This conclusory and unfounded argument, which is little more than semantics, should be rejected.

ii. The Services Do Not Dispute That Downstream Competition Has Constrained And Reduced Prices

262. As demonstrated in SoundExchange's Proposed Findings of Fact, as a matter of both economic theory and empirical fact, downstream competition in the consumer market has substantially constrained and reduced the prices of interactive streaming services. This renders the rates in interactive service agreements "effectively competitive" under any conceivable conception of what that broad standard means. *See* SX PFOF ¶¶ 450-462.

263. The Services wrongly claim that there is "no empirical support whatsoever" for this point. Pandora PFOF ¶¶ 235-36. This is simply false. As SoundExchange has shown, there is substantial evidence in the record that downstream competition in the consumer market has in fact constrained and reduced the prices in the upstream market.

264. Although the Services repeatedly resort to UMG's submissions to the FTC to support their argument that the major labels' catalogs are "must haves" for interactive streaming services, they do not address the significant evidence submitted to the FTC that piracy and other free alternatives have reduced the prices labels could charge in that market.

265. [redacted] Hr'g Ex. PAN 5349 at 48.

266. In a separate submission focused on streaming services, UMG demonstrated [redacted]

[redacted]

267. And of course, Pandora and the other Services ignore that their own experts agree with these points. Prof. Shapiro in his testimony agreed that there "is a meaningful degree of competition between pirate services and legitimate interactive services," that "competition has affected the price in the upstream licensing market," and that this competition "has caused the record companies to lower their prices to interactive streaming services." Hr'g Tr. 5049:10-25 (May 20, 2015) (Shapiro) (further noting that "I think two episodes where the price came down. The interactive price in the interactive upstream market came down in response to piracy . . . ."). As Prof. Shapiro stated in his written rebuttal testimony, the "rates paid by interactive services have been falling as a result of competition from piracy." Hr'g Ex. PAN 5023 ¶ 7 (Shapiro WRT). Prof. Katz also acknowledged that "interactive services face competition downstream from free alternatives like piracy and YouTube and Pandora," and that "these free alternatives push down the price that the record companies can charge to interactive services." Hr'g Tr. 2973:8-19 (May 11, 2015) (Katz) (noting that "they do have some sort of an effect, and I believe it's in a downward direction so, yes, at that level I agree with you."). Professor Rubinfeld also has specifically analyzed the downward trend in rates in the interactive space since 2011, demonstrating the effects of these downstream competitive forces. *See* Hr'g Ex. SX-140 (Rubinfeld Corr. WRT, Ex. 12A); *see also* Hr'g Ex. SX-17 ¶ 140 (Rubinfeld Corr. WDT).

268. This evidence that licensing rates have been falling in the interactive space as a result of downstream competition contradicts the Services' claim that the major labels have been able to set prices at supracompetitive levels. *See, e.g., Commercial Data Servers, Inc. v. Int'l Bus. Machs. Corp.*, 262 F. Supp. 2d 50, 73-74 (S.D.N.Y. 2003) ("there is no evidence in this

record that IBM had the ability to set prices at a supracompetitive level" where evidence showed that prices were "dropp[ing] significantly," and therefore "customers were getting more . . . for less money"); *Xerox Corp. v. Media Sciences, Inc.*, 660 F. Supp. 2d 535, 549 (S.D.N.Y. 2009) ("Turning to whether Xerox charged supracompetitive prices to locked-in customers, Xerox has introduced substantial uncontested evidence that its ink-stick prices have decreased on a cost-per-page basis" and noting that "[a]gainst this backdrop, the evidence cited by MSI fails to support a reasonable interference of supracompetitive pricing").

269. Moreover, at least Pandora does not appear to dispute that interactive services in their negotiations with the majors labels would have "bargaining power" based on "their ability to substitute for piracy." PAN PFOF ¶ 250.

270. Again, the Services' response to these competitive forces is largely to ignore them and maintain that the rate from the interactive space is simply a monopoly rate, no matter how much downstream competitive constraints limit and reduce that rate. Indeed, in quoting Prof. Katz, NAB argues that "even if piracy imposes some constraint, 'that doesn't render the market effectively competitive . . . it may be pressure on the monopoly price, but, nonetheless, it's a monopoly price.'" NAB PFOF ¶ 333 (quoting Hr'g Tr. 2823:8-22 (May 11, 2015) (Katz)).

271. But this amounts to little more than sophistry. As demonstrated in SoundExchange's Proposed Findings of Fact ¶¶ 465-66, even assuming that the major labels are effectively "monopolists" because of the complementary nature of their catalogs, a monopolist facing a highly elastic demand curve, as is the case here, might "technically," in a "very pedantic sense" be a "monopolist," but it is a benign monopolist: (i) "it's not going to able to charge rates" above competitive levels because "downstream end users are going to flee if those rates end up being passed on to them"; (ii) it's "not going to be able to constrain quantity the way that

monopolists sometimes do," and (iii) the degree of any "dead weight loss would be actually quite small for a monopolist who is facing a very, very elastic demand." Hr'g Tr. 6049:6-23 (May 27, 2015) (Talley). Prof. Katz himself acknowledged that the price that emerges as a result of downstream competition could be the same as the price that emerges through "effective competition," however that phrase is understood. *See* Hr'g Tr. 2977:5-14 (May 11, 2015) (Katz) ("[I]f these other factors were to push the price low enough despite the absence of effective competition, you might have a price that started looking similar. I mean, it's conceivable, if you're talking about hypotheticals, that you could have a monopoly that faced demand, that only allowed it to charge a very low price. So that's possible."); *see also id.* at 2978:19-22 ("[Y]ou might get prices that nonetheless started being close to what you would see if the market had been effectively competitive").

272. And as noted, the Services simply hypothesize that the prices *could have been lower* if there were more direct price competition between labels in the upstream licensing market, but offer no evidence or analysis demonstrating how much, if at all, the rates from the interactive streaming market would have been lower in the presence of what they describe as "effective" or "workable" competition. *See* Hr'g Tr. 2945:14-17 (May 11, 2015) (Katz) ("Q. You can't tell us what the rates would have been in those agreements if they did reflect effective competition, correct? A. That's correct."). This is again because the "concept of effective competition doesn't give you a precise number by itself," it is a "fuzzier concept." Hr'g Tr. 5660:16-21 (May 26, 2015) (Katz).

273. The Services' inability to state what the "effectively competitive" rate would be for interactive service agreements absent the complementary nature of major labels' catalogs, and how much higher the interactive service agreements' rates are over an "effectively

competitive" range of prices, renders the Services' effective competition arguments essentially meaningless. *See, e.g., Bellam v. Clayton Cnty. Hosp. Authority*, 758 F. Supp. 1488, 1494 (N.D. Ga. 1990) (even if "it is assumed that this price effect is true, injury to competition would not be established because the relevant inquiry is not whether prices will increase, but whether they will increase over the competitive level. . . . Plaintiffs, however, fail to offer any evidence regarding competitive pricing levels."); *K.M.B. Warehouse Distribs., Inc. v. Walker Mfg. Co.*, 61 F.3d 123, 128 (2d Cir. 1995) (no adverse competitive effect where defendant failed to present "empirical demonstration concerning the adverse effect of the defendants' arrangement on price" and thus "failed to come forward with any evidence that defendants' actions adversely affected . . . price market-wide"); *Tops Mkts., Inc. v. Quality Mkts, Inc.*, 142 F.3d 90, 96 (2d Cir. 1998) (no adverse effect where plaintiff alleged "potentially" higher prices, but did not demonstrate that prices were actually higher).

274. In a belated effort to demonstrate that the rates in the interactive service agreements are not competitive, NAB, relying on testimony from Prof. Katz at the hearing, argues that piracy and other free alternatives have not reduced licensing rates to "near the competitive level" because the UMG/EMI merger submissions to the FTC indicate "that the labels believed that the merger would lead to lower prices," which is "strong evidence that piracy was not lowering prices to near the competitive level." NAB PFOF ¶ 334.

275. This argument is ironic to say the least. NAB is relying on statements in the merger submissions demonstrating that licensing rates would be reduced further because of the merger as evidence that the market is *not* competitive.

276. But moreover, such arguments do not demonstrate that the interactive service agreements do not satisfy any workable or effective competition standard. At the outset, as Prof.

Rubinfeld explained, the fact that there is some complementarity among label repertoires is still consistent with there being a competitive interactive services market. Hr'g Ex. SX-29 ¶¶ 114-118 (Rubinfeld Corr. WRT). The theoretical "Cournot complements" argument put forward by Prof. Katz oversimplifies and confuses the pricing issues in this matter. As Prof. Rubinfeld has pointed out, "[c]omplementarity and competition are distinct economic concepts that are not mutually interchangeable." *Id.* ¶ 116.

277. The fact that there are two complementary products does not establish that the prices for those products are not workably or effectively competitive. [redacted]. Nor would that mean that the pre-merger prices were not already at prices that would be the same that result from an "effectively" or "workably" competitive market.

278. In Prof. Rubinfeld's [redacted]. It follows that any Cournot complement benefits to combining the labels would be expected to be modest. Moreover, Prof. Rubinfeld's bargaining model analysis (*id.* at 35-42) makes it clear that [redacted]

279. Similarly, UMG explained in its submissions to the FTC [redacted]

[redacted]. Hr'g Ex. PAN 5025 at 2.

280. In addition, by "competitive level" Prof. Katz appears to have in mind a world in which all or almost all of the benefits (or "economic rents") would *go to the interactive services* – thus leaving no room for the Services to extract *additional* price decreases. In other words, he is envisioning something akin to *perfect* competition where there are only pricetakers and never pricemakers.

281. But this is inconsistent with the Judges' prior decisions and Profs. Katz and Shapiro's own testimony in the proceeding as to what an "effectively" or "workably" competitive market is. As the *Web III Remand* points out, "[b]etween the extremes of a market with 'metaphysically perfect competition' and a monopoly (or collusive oligopoly) market devoid of competition there exists '[in] the real world . . . a mind-boggling array of different markets' . . . , all of which possess varying characteristics of a 'competitive marketplace.'" *Web III Remand*, 79 Fed Reg. 23102, n.37.

282. Profs. Shapiro and Katz similarly testified that their proffered concepts of "workable" or "effective" competition do not require anything near "perfect" competition as that phrase is understood in economics, but that such concepts generally just require a degree of competition. *See* Hr'g Ex. PAN 5022 at 11 (Shapiro WDT) ("Workable competition does not require marginal cost pricing or anything approaching the textbook model of perfect competition."); Hr'g Ex. NAB 4000 at 20 (Katz WDT) (noting that "theoretical conditions of *perfect* competition often are not satisfied in actual markets" and describing "workable" competition as markets that "are competitive, but not perfectly so"). As Profs. Katz and Shapiro testify, an effectively or workably competitive market does not require that the *services* have all

the bargaining power – to the contrary, there is a broad spectrum between perfect competition and monopoly that effective competition, whatever it is, lies somewhere within. Hr'g Tr. 2949:15-20 (May 11, 2015) (Katz) ("Q. You agree that there's a spectrum that you've used in your textbooks that has perfect competition on one end and monopoly on the other end, correct? A. Yes."). Indeed, if the all of the economic rents would go to the interactive services, if anything, that would suggest the countervailing issue of monopsony, not monopoly, rates. *See* Hr'g Ex. SX-2358 at 10 (Talley WRT).

283. And again, for these reasons, the fact that [redacted]

284. In sum, the substantial evidence in the record that downstream competition acts as a significant constraint on prices in the upstream licensing market is undisputed, and more than sufficiently satisfies any "effective" or "workable" competition requirement that might exist.

b. The Services' Response To Labels' Substantive Negotiations With Services Is Conclusory, Ignores The Judges' Prior Statements, And Ignores Real Material Concessions Made By The Labels

285. The Services do not dispute that there is substantial evidence in the record that time and again the major labels have made significant concessions on material terms in their negotiations with the majors. *See* SX PFOF ¶¶ 459-462.

286. Instead, the Services ignore this evidence and argue that it is irrelevant because even monopolists occasionally will negotiate in their dealings. *See* PAN PFOF ¶ 237; NAB PFOF ¶¶ 337-342. In so arguing, they ignore that the Judges specifically have stated that the nature of the parties' negotiations *are relevant* to the question of the competitiveness of the market, noting that where one party acts as a price-maker and makes the parties' negotiations "superfluous," this is evidence that they are exercising monopoly power. *See Web III*, 76 Fed.

Reg. 13026, 13028 (focusing on whether party "exercise[d] such monopoly power as to establish them as price-makers" thereby "mak[ing] negotiations between the parties superfluous.").

287. It is undisputed that this is not the case here. As demonstrated in SoundExchange's Proposed Findings of Fact, SX PFOF ¶¶ 470-71, these were prolonged, hard-fought negotiations in which the interactive streaming services demanded and obtained material, preferred terms. Indeed, as Prof. Katz acknowledged, he reviewed contracts where Spotify "may have paid a lower percentage than some other companies. It's conceivable that that was in the exercise of bargaining power." Hr'g Tr. 2981:19-2982:3 (May 11, 2015) (Katz).

288. The Services' claim that even monopolists will negotiate at times is a red herring. The Services offer no analysis as to what types of negotiations are demonstrative of competition and what kinds of negotiations are demonstrative of monopolists. In fact, NAB relies almost exclusively on Prof. Katz's testimony at the hearing that the "mere fact that your customer asks for something and you say, okay, I will give that to you, particularly if that is going to help you get more money, the fact that you do that doesn't show you lack monopoly power. It shows you are economically rational." NAB PFOF ¶ 340 (quoting Hr'g Tr. 5715:20-5716:3 (May 26, 2015) (Katz)).

289. But that is not what the evidence here shows. As Prof. Rubinfeld described, [redacted] Hr'g Tr. 1863:7-15 (May 5, 2015) (Rubinfeld). This is not simply a situation where a label makes an economically rational decision to give on a term to make more money. Rather, they show the labels compromising on

terms and accepting lower rates. *See* SX PFOF ¶¶ 471-480. If, as the Services claim, they had all the bargaining power and could have held out, they would have done so. They did not.

290. And this is because of the Services' commensurate bargaining power. As an example, in its negotiations with Warner, [ )]. When Spotify and Warner resumed negotiations for the next term,] Similarly, in [ ] There are numerous other similar examples, as described in SoundExchange's Proposed Findings of Fact. *See* SX PFOF ¶¶ 471-480.

c. The Services Concede That The Non-Interactive Space That Is The Focus Of The Statutory License Would Have The Same Bargaining Dynamics As The Interactive Space

291. The Services' effective or workable competition argument also is erroneous because to the extent the catalogs of major labels are "must haves" in the interactive streaming

space, their catalogs equally would be "must-haves" in the non-interactive space that is the focus of the willing buyer/willing seller hypothetical market. The Services do not dispute this.

292. Prof. Katz, for example, agrees that the catalogs of the major labels would likely be must-haves in the non-interactive space. *See* Hr'g Tr. 2989:10-2990:1 (May 11, 2015) (Katz) ("Q. Is it fair to say that you think today that for many simulcasters, Universal, Sony and Warner would be must-haves? A. Yes. Q. Is it fair to say that you also believe that the majors are must-haves for customized services such as Pandora? A. I would say I believe that's a possibility, yes.").

293. For example, if Pandora did not have access to UMG's catalog, then one out of every 3 times a Pandora user seeded a station with the name of an artist, that user may never hear any tracks from that artist. As Prof. Katz testified, "the users who tried that would be disappointed." Hr'g Tr. 2993:15-22 (May 11, 2015) (Katz). Indeed, a competitor like iHeart or iTunes Radio that did have all of the music that was missing from Pandora might be a very attractive alternative for users. *See id.* at 2993:23-2994:2 ("It could be."). It would also be difficult for Pandora to succeed over the long term if it is not able to give a large percentage of users the music they want to hear. *Id.* at 2994:3-7 ("Q. It's pretty hard for Pandora to succeed long-term if it isn't able to give the users the music they want to hear, correct? A. That would be true – that's true for a large percentage of users, yes.").

294. Pandora's steering experiments, as discussed in greater detail below, not only do not demonstrate otherwise, but actually solidify the must-have status of major labels' catalogs for Pandora. First, they notably do *not* demonstrate the impact on steering where there is a loss of 100% of a label's catalog, which would be the relevant question for the threat point analysis. *See* Hr'g Ex. SX-19 at 32-33 (Talley WRT). Second, the experiments do show material drop-

offs in listenership when there is steering away from a major at a level of approximately 30%. *See id.*; *see also* Hr'g Ex. SX-29 ¶¶ 140-154 (Rubinfeld Corr. WRT). Such levels demonstrate that Pandora could not survive – and certainly could not succeed – without the catalogs of all three majors. *See id.*

295. The Services do not dispute any of this. Instead, they attempt to dismiss such facts as "irrelevant" because the "relevant question is not whether an interactive market that lacks effective competition may be used as a benchmark for a noninteractive licensing market that also lacks effective competition." NAB PFOF ¶¶ 343-46; *see also* Pandora PFOF ¶¶ 82-83 (describing this reality as "cynical" and "perverse" though not disputing).

296. The Services therefore suggest that the hypothetical marketplace envisioned by the statutory license would need to be one different than the market as it currently exists today. As discussed, *supra,* Section II, and in SoundExchange's Conclusions of Law, there is no legal support for that conclusion. And indeed, the practical implications of such a rule would render the entire benchmarking exercise impossible.

297. First, as Prof. Katz acknowledged, one would have to envision entirely different record companies than those that presently exist today, and the market itself would look fundamentally different. Hr'g Tr. 3005:5-15 (May 11, 2015) (Katz) ("Q. And if instead what we did is we reduced the recordings and artists that Universal, Sony, and Warner controlled, from where they are today, to whatever the level is that would make them not must-haves, the market would also look different than it looks today, correct? A. Well, yes, I mean, almost by definition because you said you're changing the market, yes. Q. So the majors wouldn't be majors, correct? A. If you moved it away enough, correct.").

298. Moreover, the agreements themselves that emerge in this re-envisioned marketplace would look different than the agreements we see in the actual world. *See* Hr'g Tr. 3005:16-19 (May 11, 2015) (Katz) ("Q. And the deals that they have reached with streaming services would look different, wouldn't they? A. I believe they would.").

299. The Services have not proposed, much less demonstrated, any sort of methodology to create this alternative hypothetical universe. Indeed, as Prof. Katz acknowledged, he was unable to say how much market power – and artists – one would need to take away from a major label such that they would no longer be a must have. *See* Hr'g Tr. 3000:14-17 (May 11, 2015) (Katz) (Q. You can't tell us how much we have to take away from Universal to make it not a must-have, correct? A. That's correct."). Indeed, Prof. Katz testified that while he thought about doing an analysis of what the market would look like where the majors "are no longer must-haves," he "thought about doing this sort of thought experiment, but wasn't – didn't come up with a reliable way to turn that into numbers or a prediction." *See* Hr'g Tr. 3004:16-3005:4 (May 11, 2015) (Katz).

d. The Services' Suggestion That [redacted] Are Anti-competitive Is Conclusory And Unsupported, And Contradicted By Record Evidence

300. At the hearing, the Services began to espouse a new theory to demonstrate that the interactive services benchmark is purportedly not the result of competitive forces – that record labels allegedly eliminate competition with one another through MFN provisions in agreements. This new theory is repeated in their proposed findings of fact. *See* PAN PFOF ¶¶ 228-231.

301. The Services' argument, however, has no actual basis in economic theory or fact. First, there is nothing inherently anti-competitive about MFNs. Hr'g Tr. 1864:21-1865:3 (May 5, 2015) (Rubinfeld) [redacted]

[redacted]). Indeed, as courts have held, MFNs are subject to a rule of reason analysis, and can have procompetitive benefits and legitimate business justifications that outweigh any purported anti-competitive effects.[15] The Services ignore any such benefits in their conclusory claim that the mere existence of MFNs (which may not even be triggered) has resulted in anticompetitive effects. Indeed, none of the Services' several experts has done any economic analysis or offered any economic opinions on the procompetitive versus anticompetitive effects of MFNs in the interactive service agreements. There simply is no factual record here to support the claim MFNs have led to any anticompetitive effects in the interactive services space.

302. Further, there is no evidence at all in the record that any MFN provisions in any interactive service agreements were even triggered. The Services' speculation that they have resulted in anticompetitive pricing simply assumes, without any evidence, that such provisions have become effective.

303. Moreover, if anything, the evidence in the record shows that such provisions have resulted in lower, not higher, licensing rates to the Services' benefit. Hr'g Tr. 2550:6-22 (May 7, 2015) (Wilcox) [redacted]

[15] And indeed, a number of courts have found MFNs to be procompetitive and not in violation of the antitrust laws. *See Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995); *Ocean State Physicians Health Plan v. Blue Cross & Blue Shield of Rhode Island*, 883 F.2d 1101, 1109–13 (1st Cir. 1989), cert. denied, 494 U.S. 1027 (1990); *Kitsap Physicians Service v. Washington Dental Service*, 671 F. Supp. 1267 (W.D.Wash.1987); *Blue Cross & Blue Shield of Mich. v. Michigan Ass'n of Psychotherapy Clinics*, 1980 WL 1848 (E.D. Mich. 1980).

[redacted]

2. iHeartMedia's Representativeness Attack On The Interactive Benchmark Fails

304. As demonstrated in SoundExchange's Proposed Findings of Fact (SX PFOF ¶¶ 358-371), the interactive service agreements are also an important benchmark in this proceeding because SoundExchange's analysis of those agreements is based upon a thick, representative market of agreement data. This market involves a broad spectrum of labels, including both major and independent record companies; a wide variety of different services including large corporate players like Spotify, Google, and Apple/Beats to smaller startups like Rara that have more specialized offerings, and an extensive period of time going back over the past four years, with a focus on the last year of available data to ascertain current trends.

305. The Judges have repeatedly cautioned against relying upon agreements struck between a limited set of unrepresentative buyers or sellers. As the Judges noted in the *Web III Remand* decision, "[t]o the extent" the parties to an agreement are "not sufficiently representative," the analysis of such an agreement "would yield an inaccurate royalty rate." *Web III Remand* at 23108; *see also SDARS II* at 23,061 (criticizing potential benchmark that "represent[s] a sliver of the universe of rights holders for sound recordings.").

306. iHeart argues that the interactive services market examined by Prof. Rubinfeld is in fact not broad, and that his review of agreements equates to the independent agreements iHeart has proposed as benchmarks. *See* IHM PFOF ¶¶ 267-268. It is noteworthy that Pandora, who offers essentially one benchmark agreement – the Pandora-Merlin agreement – and NAB, who

offers no benchmark agreements, have not joined in iHeart's critique. In any event, iHeart's argument is wrong.

307. First, iHeart incorrectly states that SoundExchange's analysis is limited to 26 interactive service agreements. In analyzing the interactive services space, Prof. Rubinfeld analyzed more than 80 label-service pairs between interactive streaming services and major and independent record labels going back over the past four years. *See* Hr'g Ex. SX-29 (Rubinfeld Corr. WRT); Hr'g Ex. SX-128 (Rubinfeld Corr. WRT App. 2); Hr'g Tr. 1783:2-1784:1 (May 5, 2015) (Rubinfeld). Prof. Rubinfeld calculated the effective compensation per play for these interactive streaming agreements going back to January 2011, and has analyzed the trend in those rates since that time until September 2014. *See* Hr'g Ex. SX-140 (Rubinfeld Corr. WRT, Ex. 12A); *see also* Hr'g Ex. SX-17 ¶ 140 (Rubinfeld Corr. WDT).

308. To reflect the most current trend in rates, Prof. Rubinfeld's reported calculations are based upon only the last year of available data. *See* Hr'g Ex. SX-17 ¶¶ 120 & n.87, 140 (Rubinfeld Corr. WDT). From the more than 80 label-service pairs Prof. Rubinfeld reviewed, he calculated effective per-play rates from 45 different agreements, and adjusted minimum per-play rates from 26 agreements (and any amendments thereto). *See* Hr'g Ex. SX-17 (Rubinfeld Corr. WDT); Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex. 16a); Hr'g Ex. SX-63 (Rubinfeld Corr. WDT App. 1a).

309. As SoundExchange noted in its Proposed Findings of Fact, the concept of representativeness is not simply a counting game – rather, the Judges must examine the nature of the agreements, the parties to the agreements, the overall effect on the market those agreements may have had, and whether the rates in those agreements can be universalized across the industry.

310. The interactive agreements include those struck by large platform-level streaming services such as Spotify or Google Play, and smaller streaming services like Rara and Classical Archives. *See* Hr'g Ex. SX-29 (Rubinfeld Corr. WRT); Hr'g Ex. SX-128 (Rubinfeld Corr. WRT App. 2); Hr'g Tr. 1783:2-1784:1 (May 5, 2015) (Rubinfeld). These services, as noted, offer a broad range of service offerings, including non-interactive, lean-back options like curated radio in addition to traditional on-demand options. Prof. Rubinfeld's review also included agreements with both major and independent labels, including independent labels such as Beggars Group, Secretly Canadian, and Merlin. *See* Hr'g Ex. SX-29 (Rubinfeld Corr. WRT); Hr'g Ex. SX-128 (Rubinfeld Corr. WRT App. 2); Hr'g Tr. 1783:2-1784:1 (May 5, 2015) (Rubinfeld). And as noted, Prof. Rubinfeld has analyzed those agreements going back nearly 4 years, from January 2011 to September 2014. *See* Hr'g Ex. SX-140 (Rubinfeld Corr. WRT, Ex. 12A); *see also* Hr'g Ex. SX-17 ¶ 140 (Rubinfeld Corr. WDT).

311. Moreover, the agreements Prof. Rubinfeld reviewed were for interactive services that had both free and subscription tiers, such as Spotify. The free tiers of such services typically are a means by which services can incentivize conversion to their paid subscription tiers. *See* Hr'g Ex. SX-17, ¶¶ 50, 173 (Rubinfeld Corr. WDT) (noting that "[Slacker and Rdio] both operate directly licensed free radio services which are explicitly designed to motivate listeners to convert to paid 'on demand' service").

312. By contrast, the 27 agreements iHeart touts were all between iHeart and independent labels, who not only lack the bargaining power that a major label would have, but who also have unique incentives and business motivations that cannot be extrapolated to the entire industry. *See* Hr'g Ex. SX-29 ¶¶ 84-85 (Rubinfeld Corr. WRT). As noted, Mr. Barros,

CEO of Concord Records, who entered into one of these direct agreements with iHeart, testified that

> while every record company may have certain differences in its repertoire, for us, issues like whether a music service will pay for performances of Pre-72 recordings have a significant impact on our assessment of the value we receive from licensing our repertoire to a service. . . . Such idiosyncratic reasoning is especially true among independent record companies who vary greatly in shape and size and often can be driven in their decision-making by a host of label-specific considerations.

Hr'g Ex. SX-1 ¶ 12 (Barros WRT).

313. Moreover, the number of plays represented by these agreements with independent labels on iHeartRadio are again a "sliver of the universe of rights holders for sound recordings." iHeart's own data [redacted] Hr'g Ex. SX-29 ¶ 84 (Rubinfeld Corr. WRT).

314. In sum, there is no real dispute that the interactive service agreements benchmark is based upon a thick, representative market of agreement data, involves a broad spectrum of labels, including both major and independent record companies and a wide variety of different services including large and small. As compared to iHeart's independent deals, and including as well the iHeart-Warner and Pandora-Merlin agreements, the interactive benchmark is by far based upon the most expansive, representative set of agreement data. No other party has proposed a set of agreements that comes close to the interactive benchmark in terms of the representativeness of the market data presented.

3. The Services Do Not Rebut The Fact That The Interactive Benchmark Is Least Affected By The Statutory Shadow

315. The Services, and iHeart in particular, attempt to downplay the minimized presence of the statutory shadow as an advantage of the interactive service agreements. *See, e.g.*, IHM PFOF ¶¶ 269-271. This argument is without merit for several reasons.

316. First, as noted, the statutory license casts a shadow across the entire streaming industry, and all agreements, including the interactive agreements, are affected to varying degrees by this shadow. Hr'g Ex. SX-17 ¶ 91 (Rubinfeld Corr. WDT). Because the interactive agreements offer certain functionality that prevents the services from immediately falling back to the statutory license if an agreement is not reached, they are not directly influenced by the existing statutory rates. *Id.* ¶ 18. The Services agree on this point. As Prof. Shapiro has stated: "I agree with Professor Rubinfeld that the interactive services do not have the option of electing the statutory license, so the interactive licenses are less influenced by the statutory license than are the licenses signed with statutory webcasters." Hr'g Ex. PAN 5023 at 4; *see also id.* at 6 ("I agree with Professor Rubinfeld that agreements signed by statutory webcasters are influenced more by the availability of the statutory license than are agreements signed by interactive services."); Hr'g Tr. 2669:8-10 (May 8, 2015) (Shapiro) (problem with shadow is "less true for the interactive benchmark because it's not as, at least, directly influenced by the statutory license").

317. The Services, and iHeart in particular, nonetheless appear to suggest that the non-interactive directly licensed benchmarks they rely upon are less affected by the statutory shadow because these agreements purportedly have rates "below" the current statutory rate, allegedly demonstrating that the rate is too high. *See, e.g.,* IHM PFOF ¶¶ 269-271. This claim fails.

318. As iHeart's own experts testify, "[a]dmittedly, there is a drawback associated with relying on evidence from noninteractive licensing agreements: these agreements were negotiated

in the 'shadow' of the statutory rate." Hr'g Ex. IHM 3054 ¶ 51 (Fischel-Lichtman WRT). The fact that there are some non-interactive agreements with rates below the statutory rate does not demonstrate that the existing rate is too high, or that those agreements are not equally affected by the statutory shadow.

319. As Prof. Talley explained and demonstrated through his use of structural modeling techniques, regardless of allocation of bargaining power, the range of negotiated prices in agreements negotiated under the shadow of a statutory license will generally be below those that would otherwise exist in the absence of a statutory rate. The reason for this is that the statutory license option crowds out a significant fraction of deals that would otherwise be negotiated transactions above or near the statutory rate, leaving behind only a subset of transactions with relatively low prices below the statutory rate. Hr'g Ex. SX-19 at 48-60 (Talley WRT); Hr'g Tr. 6021:25-6030:4, 6034:4-6037:19 (May 27, 2015) (Talley). Thus, the Services' claim that "most" non-interactive agreements have rates "below" the current statutory rate is meaningless, as we are not seeing all of the agreements that would have been made above the statutory rate but that are crowded out because of the statutory license.

320. Further, the Services are simply incorrect in claiming that even for those remaining non-interactive agreements that exist, most are "below" the statutory rate. As noted, agreements also may be reached in the shadow of the statutory license where the parties value the consideration provided in the agreement differently (as is the case, for example, with the Pandora-Merlin agreement and the iHeart-Warner agreement). Both Merlin and Warner valued their deals with Pandora and iHeart, respectively, as being worth *at least* the statutory rate if not *more* to them. *See infra*, Sections IV, V. Indeed, at the hearing, Prof. Fischel stated that iHeart did, in fact, analyze all the various scenarios for the iHeart-Warner agreement and found some

that [redacted]. Hr'g Tr. 5365:11-12 (May 21, 2015) (Fischel).

321. Moreover, iHeart's suggestion that it has addressed the statutory shadow in its incremental rate analysis is wrong. As explained in SoundExchange's Proposed Findings of Fact and herein, incremental approach is divorced from economic theory or reality. *See* Section V.A, *infra*. Properly considered, the iHeart-Warner agreement cannot justify a rate of $0.0005 and instead suggests that SoundExchange's rate proposal of $.0025 is conservative.

322. Moreover, the effects of the shadow are somewhat reduced where the parties depart from structure of the statutory license through alternative compensation arrangements, such as flat fees that allocate risk between the parties based on potential performance, [redacted] Section III.F, *infra* As noted, wherever there is a [redacted], there will be uncertainty and risk on both sides as to what the ultimate effective per-play rate will be. In the specific context of the [redacted] *See* Section III.F, *infra* .

323. Finally, SoundExchange has pointed to agreements for non-interactive services that have rates at or above the existing statutory rates, such as for Beats "The Sentence." Given that the statutory license does not require a commitment by a statutory licensee to offer a higher ARPU subscription offering, SoundExchange has analyzed the rates that would apply when there is no or little conversion. [redacted] the stated rates agreed to between Beats Music and Universal, Warner, and Sony, [redacted]

[redacted],] range from [redacted] per play in 2014, rates which are at or above the existing statutory rate. Hr'g Ex. SX-29 ¶ 162 (Rubinfeld Corr. WRT).

4. The Purported "Differences" Between Interactive And Non-Interactive Services Are Unfounded And Irrelevant

324. The Services have put forth a number of "differences" between the interactive and non-interactive spaces which they claim render the interactive benchmark improper. These distinctions are either imagined or irrelevant and do not undermine the importance of the interactive benchmark.

a. Purported Ability To Steer

325. The Services argue that the interactive services should be disregarded because, unlike the non-interactive services, they purportedly lack the "ability to steer." Pandora PFOF ¶¶ 245-252; IHM PFOF ¶ 290-293. As described in SoundExchange's Proposed Findings of Fact and herein, this is a false distinction for several reasons. *See* SX PFOF ¶¶ 697-747; Section IV.E, *infra*.

326. First, the Services' evidence of steering is premised entirely on [redacted], which is not a valid benchmark agreement because it is mathematically impossible to steer to every record label. Accordingly, a steering commitment cannot be a part of the statutory license.

327. Second, there is no evidence that the threat of steering alone would induce price competition among record companies. The record is bereft of *any* benchmark agreement that reflects this dynamic. In other words, there is not a single agreement in the record in which a record company offered a lower price to a webcaster simply to avoid the webcaster's credible threat of steering. Rather, the benchmark agreements in the record that involve steering each involve a [redacted]. The Services have pointed to no examples in which a label

took a price discount because of the threat of steering. At best, the Services only have demonstrated that a label will take a headline rate discount where it will obtain additional consideration that renders the deal equal to or exceeding the value of the existing statutory license.

328. Third, any steering that has occurred by non-interactive services is largely if not entirely the result of the statutory license itself. Pandora and iHeart's rate proposals rest primarily on their ability to steer toward a particular label, which necessarily entails steering *away* from other labels. And as Prof. Shapiro admits, for the mere threat of steering to work, it has to be credible. Hr'g Tr. 4564:7-11 (May 19, 2015) (Shapiro). But as Prof. Talley explained at the hearing, Pandora and iHeart are able to "threaten to steer" because there is "essentially a safety net that they are working with," i.e., the statutory license. Hr'g Tr. 6075:2-16 (May 27, 2015) (Talley). By contrast, in the absence of a statutory license, a major label may seek to protect against themselves against steering by, e.g., refusing to license. *Id.* So "to the extent that that safety net is providing the type of ammunition to threaten to steer against, I can always get the majors on the statutory license, then that probably shouldn't be what we're considering when we consider the hypothetical market in the absence" of the statutory license. *Id.* at 6075:17-22.

329. Prof. Shapiro conceded that a record company in the absence of the statutory license may be able to disable a webcaster's threat of steering. Hr'g Tr. 4576:14 – 4577:5 (May 19, 2015) (Shapiro). At the hearing, the Judges asked Prof. Shapiro whether it was possible for a record company to take the following negotiating position in the absence of a statutory license: "Give us the rate we negotiated and no steering or we're pulling all our music from you. . . . You don't steer away, and you pay the same rate, and you play me at [the] same proportionate share

as you always do." Hr'g Tr. 4576:3-13, 4576:22-25 (May 19, 2105) (Shapiro). Prof. Shapiro admitted that this would be a possibility: "I think that's exactly right. I happen to have studied exactly this dynamic intensively in the negotiations between programmers and cable television companies." Hr'g Tr. 4577:16-20 (May 19, 2015) (Shapiro). And Prof. Shapiro acknowledged that he did not know what the result of this "game of chicken" would be. *Id.* at 4577:22 – 4578:22.

330. Finally, there are several other examples of directly licensed non-interactive services that have equal if not greater ability to steer than Pandora or iHeart, yet have rates consistent with SoundExchange's rate proposal, not any of the Services' proposals. For example, under the terms applicable to Beats "The Sentence," [redacted] Hr'g Ex. SX-36 at 12 [(redacted)]; *see also* Hr'g Ex. SX-29 ¶ 180 (Rubinfeld Corr. WRT). That gives Beats "The Sentence" even greater ability to steer than Pandora, for example, but as noted, the rates for "The Sentence" are equal to or exceed SoundExchange's rate proposal.

331. Similarly, Apple in its iTunes Radio service equally has the ability to steer listeners to music offered by different labels, including independents. Hr'g Ex. SX-29 ¶¶ 114, 118 (Rubinfeld Corr. WRT). As demonstrated in SoundExchange's Proposed Findings of Fact, and below, Section III.F, *infra* , the rates in the Apple iTunes Radio agreements—from either a performance or a projections perspective—support SoundExchange's rate proposal.

b. The Services Have Not Put Forth Any Evidence That Non-interactive Services Are More Promotional Than Interactive Services

332. The Services argue that another distinguishing factor of interactive services from non-interactive services is that they are purportedly less promotional, and that SoundExchange has failed to make any adjustment for this alleged promotional delta. *See* Pandora PFOF ¶¶ 253-58; IHM PFOF ¶¶ 274, 294. Again, this claim lacks any evidentiary basis.

333. As demonstrated in SoundExchange's Proposed Findings of Fact and herein (*see* SX PFOF ¶¶ 1105-1131; Section II.B, *supra*), the evidence in the record demonstrates that statutory webcasting services are net substitutional rather than net promotional. Moreover, the Services' proffered evidence does not support a finding that statutory webcasting services are promotional at all. *See* SoundExchange PFOF ¶¶ 1162-86. Indeed, iHeart tried, and failed, to demonstrate that non-interactive services have a net promotional effect as compared to interactive services. *See* SX PFOF ¶¶ 1114-1161. The analysis of SoundExchange's expert, Dr. Blackburn, of data relied on by iHeart's original testifying expert (Prof. Danaher) shows no net promotional effect one way or another. *Id.*

c. The Services' Argument That Simulcast Services Are "Different" Is Misplaced

334. The Services, and iHeart in particular, also argue that the interactive services benchmark is inappropriate as applied to simulcast services, which it describes as "different." IHM PFOF ¶¶ 334-350. This argument also is without merit.

335. First, as demonstrated in SoundExchange's Proposed Findings of Fact, SX PFOF ¶ 290, the blurring of the lines between interactive and non-interactive services exists for simulcast as well as non-simulcast services. As a result of rapidly evolving technology, ["[redacted]] (Hr'g Ex. SX-2207), and the proliferation of

aggregator services like TuneIn, simulcasts also allow consumers to lean in and control their listening experience. "In practice, simulcast streaming services operate in such a way as to closely resemble the experience of on-demand listening." Hr'g Ex. SX-27 at 4 (Kooker WRT). When a user searches for a genre, geographic area, or even particular artist, simulcast aggregators like iHeart and TuneIn will instantly display not only a list of stations, but also the songs that have just started playing on those stations. Hr'g Tr. 5841:11-14 (May 26, 2015) (Dimick). Hr'g Tr. 6556:10-6560:22 (May 29, 2015) (Kooker); Hr'g Ex. SX-27 at 3-6 (Kooker WRT). And once a live stream is accessed, a user on TuneIn can pause and record songs. Hr'g Tr. 5850:9-5851:7 (May 26, 2015) (Dimick). *See also infra* at Section VI.

336. More generally, the Judges should reject the implicit suggestion here to segment the statutory rate to provide a discount for simulcast. The statutory rate should be a single rate structure that allows for the full functionality permitted under the statute. No party actually proposed a rate structure that included a different rate for simulcasters versus other webcasters, and it would be improper for the reasons explained in SoundExchange's Proposed Findings of Fact and herein, *infra* Section VI.

5. The Interactivity Adjustment Is Proper

337. The Services levy a number of attacks on the interactivity adjustment SoundExchange applies to the interactive benchmark rate. Each of these critiques is unfounded and does not undermine the importance of the interactive benchmark.

a. The Interactivity Adjustment is Not "Circular"

338. The Services, and Pandora in particular (PAN PFOF ¶ 261), argue that Prof. Rubinfeld's interactivity adjustment simply "get[s] us back to the statutory rate" because the adjustment only accounts for functionality above the statutory rate. *Id.* This argument is incorrect and mischaracterizes Prof. Rubinfeld's testimony for several reasons.

339. First, there is no evidence in the record that any negotiations between an interactive service and a label involved a negotiation with respect to the incremental value of any additional functionality beyond that authorized by the statutory license. Because those services are further removed from the statutory shadow, their underlying rates are in turn further removed and are not simply the statutory license plus some incremental additional value.

340. And this is because, as Prof. Rubinfeld has explained, different services vary according to their abilities to credibly adopt the statutory license. It follows that the functionality values of the interactive services will vary by service, according to their business models and strategies. The Services agree that the interactive services are least affected by the statutory shadow because of the difficulty of them altering their business model and opting the statutory rate. As Prof. Shapiro has stated: "I agree with Professor Rubinfeld that the interactive services do not have the option of electing the statutory license, so the interactive licenses are less influenced by the statutory license than are the licenses signed with statutory webcasters." Hr'g Ex. PAN 5023 at 4; *see also id.* at 6 ("I agree with Professor Rubinfeld that agreements signed by statutory webcasters are influenced more by the availability of the statutory license than are agreements signed by interactive services."); Hr'g Tr. 2669:8-10 (May 8, 2015) (Shapiro) (problem with shadow is "less true for the interactive benchmark because it's not as, at least, directly influenced by the statutory license"). Thus, because interactive service agreements are least affected by the shadow, it is not the case that the interactivity adjustment simply takes the rates in those services back to the statutory level.

341. Moreover, as discussed, several factors relating to the increased values placed on the heterogeneity of new and improved platform-level services have influenced the negotiated rates above and beyond the pure functional differences between the interactive and statutory

services. For this reason, the Rubinfeld analysis has relied whenever possible on the most recent amendments to the interactive agreements, which renders such rates even less affected by the statutory shadow.

342. Further, this claim also would only be true in a world of perfect competition with a large number of small competitive services. In the real world of competition that includes several large services, likely enjoying economies of scale and bargaining power, the claim fails.

343. And in fact, the actual data from the interactive service agreements demonstrates that this argument is wrong. As noted, for purposes of deriving a benchmark calculation for his per-play rate proposal, Prof. Rubinfeld conservatively relied only on the agreements' *stated* minimum per-play rates, even if the record companies were actually paid under other payment branches that conveyed substantially more compensation per play. Had Prof. Rubinfeld instead relied on the average *effective* per-play rates in the interactive service agreements and applied his interactivity adjustment, his proposed rate would have been nearly twice as high. Hr'g Ex. SX-59 (Rubinfeld Corr. WDT Ex. 16a) (showing average adjusted effective per-play rate of [redacted]). Thus, the effective per-play rates in the agreement, which represent their actual value to the labels on a per-stream basis, demonstrate that simply applying the interactivity adjustment does not lead to rates back at the statutory level.

b. The Interactivity Adjustment Ratio Is Appropriate

344. The Services attempt to undercut the interactivity adjustment by claiming that it is based on an unfounded assumption regarding the relationship between subscription prices and licensing rates. *See* PAN PFOF ¶ 262; NAB PFOF ¶¶ 252-255. The Services' argument ignores or misstates the substantial evidence in the record on this issue.

345. As Prof. Rubinfeld testified at the hearing, the assumption that the ratio of subscription prices and licensing rates is comparable for both interactive and non-interactive

services is based on three facts: (1) music is the key input for both interactive and non-interactive services; (2) there's very little substitutability in terms of that input (e.g., streaming services cannot start selling used cars instead of streamed music); and (3) the downstream elasticity of demands are relatively similar for both interactive and non-interactive services. *See* Hr'g Tr. 6308:7-6311:7 (May 28, 2015) (Rubinfeld); SX PFOF ¶ 404; *see also* Hr'g Tr. 6054:4-6055:22; 6057:15-6058:22 (May 27, 2015) (Talley) (because downstream consumer streaming markets "exhibit these types of high price elasticities," one "would expect those elasticities, in fact, to be passed up to the demand for the input" and noting a "very strong tie between the downstream market and the upstream market").

346. On his third point regarding the similarity of downstream elasticity demands, Prof. Rubinfeld explained in his 2012 presentation to the FTC that the [redacted]. Hr'g Ex. NAB 4129 at 37. Pandora fully agrees with this, describing its users as [redacted] with respect to listening to both interactive and non-interactive streaming services. [redacted].

347. The Services' own internal documents also make abundantly clear that the Services are competing with interactive services for the very same listeners, demonstrating the relative similarities in the downstream elasticities of demand. *See* Section II.B.2, *supra.* As noted, [redacted] interactive services "compete head-to-head for listener hours with services that operate under the statutory license." Hr'g Ex. SX-12 at 16

(Kooker WDT). [redacted] Hr'g Ex. 266 at 12; Hr'g Tr. 3483:23-3484:10 (May 13, 2015) (Herring). [redacted]. Hr'g Ex. 266 at 15-21.

348. [redacted] Hr'g. Ex. SX-2367 at 7; Hr'g Tr. 6163:25-6165:11 (May 27, 2015) (Fleming-Wood). [redacted]

349. [redacted] *Id.* at 2, 6. In the same email, iHeart also set forth [redacted] *Id.* at 1. [redacted]

[redacted]

See, e.g., SX-1262 at 4-11; SX-2157 at 5.

350. Using Lerner's Rule (relied on by Prof. Shapiro), these three factors therefore indicate similar percentage markups of price over cost for both interactive and non-interactive services.[16] Given that license fees are the most significant variable cost for the services, and the similarity in demand elasticities in the downstream market, it follows that the ratio of the license fee to the subscription price will be similar for both types of services. *See* Hr'g Tr. 6308:7-6311:7 (May 28, 2015) (Rubinfeld); SX PFOF ¶ 404; *see also* Hr'g Tr. 6054:4-6055:22; 6057:15-6058:22 (May 27, 2015) (Talley). In essence, the logic put forward by Prof. Rubinfeld is a simplified version of the Hicks-Marshall conditions that was mentioned by economists for both sides and the Judges at the hearing.

351. The claim (NAB PFOF ¶ 359) that this analysis contradicts Prof. Rubinfeld's earlier testimony is wrong. NAB relies on a single, generalized statement in Prof. Rubinfeld's testimony that "differences in price elasticities will also reflect differences in the technical features of the services as well as their business models." Hr'g Ex. SX-17 ¶ 110 (Rubinfeld Corr. WDT). NAB ignores, however, that Prof. Rubinfeld also stated in his testimony that the "services' elasticities of demand reflect the preferences of their listeners," that "there has been a substantial convergence in functionality and the ways in which consumers engage with non-interactive and interactive services," and that "[a]s a result, consumers are likely to view alternative services as relatively close substitutes for each other." *Id.* ¶¶ 21, 110. Moreover, in his written rebuttal testimony, Prof. Rubinfeld testified that he had "not seen compelling

[16] Lerner's Rule equates the percentage markup [(price – cost)/price] to 1/(magnitude of the price elasticity of demand). *See* Hr'g Ex. PAN 5055 at 5 n.4 (Shapiro WDT).

evidence of the differences in demand elasticities among distinct segments of services." Hr'g Ex. SX-29 ¶ 208 (Rubinfeld Corr. WRT).

352. Prof. Rubinfeld's testimony at the hearing further explained why his assumption that the ratio of the license fee (royalty rate) to the subscription price for interactive and non-interactive services was reasonable, not that there was an exact equality in demand elasticities. And as explained, the convergence in service offerings and competition for listeners supports the view that the elasticities of demand for the two types of services have moved closer to each other. Prof. Rubinfeld never claimed that there would be an exact equality between the license fee/subscription price ratios, just a reasonable approximation.

353. Prof. Rubinfeld also shows that although various interactive services are offered at a variety of subscription prices in the marketplace, the royalties paid represent a nearly constant percentage of those services' subscription revenues. *See* Hr'g Ex. SX-29 ¶ 172 (Rubinfeld Corr. WRT), Hr'g Ex. SX-143 (Rubinfeld Corr. WRT Ex. 15); Hr'g Tr. 1870:17-1871:11; 1875:18-1876:13 (May 5, 2015) (Rubinfeld) [redacted]

354. NAB (PFOF ¶ 354) argues that this fact is irrelevant because it does not show a similar relationship for statutory non-interactive services. But it would make no sense to focus on the relationship between subscription prices and licensing rates for statutory services because the licensing rates are largely if not wholly a function of the statute itself, running squarely into the shadow problem. Prof. Rubinfeld's primary point in relying upon this exhibit is to generally

demonstrate the relationship between licensees' fees and subscription prices; NAB does not provide any reason why that relationship would be different for non-interactive services absent the statutory license.

355. NAB also argues (NAB PFOF ¶ 354) that Prof. Rubinfeld's analysis in Exhibit 15 is unreliable because the various interactive services' subscription prices in the exhibit reflect different price points offered by the same interactive service, which were negotiated simultaneously with the record label. This is irrelevant; the Services could have negotiated for a lower percentage of revenue or relative per-subscriber minimum for the lower price points, but they did not. Moreover, NAB acknowledges that there are some independent price points in the chart that are not part of a bundled agreement with a different price point (Classical Archives). *Id.*

356. iHeart also argues that there is no constant ratio between effective royalty rates in interactive service agreements and subscription prices for those services (IHM PFOF ¶¶ 278-281), which they claim undermines the interactivity adjustment ratio. This argument also attacks a straw man because Prof. Rubinfeld was never claiming that all royalty/price ratios would be expected to be the same; indeed, his testimony has stressed the existing variability in service offerings. Rather, the core of his analysis was focused on the ratio of average subscription prices.

357. Moreover, this argument rests almost exclusively on various interactive services having differing *effective* per-play rates. *See* IHM PFOF ¶ 278 (noting variation in Google, Spotify, and Microsoft effective per-play rates notwithstanding similar consumer subscription price points); *id* ¶¶ 279-281. But this ignores that these services have effective revenue shares ranging tightly [[redacted]], even though market subscription prices differ. *See* Hr'g Ex.

SX-143 (Rubinfeld Corr. WDT, Ex. 15 "Backup to Exhibit 15"). As a percentage of revenue, these Services' payments to labels are very similar. For the Premium ($9.99) products for Beats, Google Play, Microsoft, and Spotify, all of the effective revenue shares are [ ]. *See id.* Moreover, the per-subscriber minimum for these Services are also within the same close range, as relative to the subscription price point. *Id.* The same is true if you add in the Premium products for Classical Archives ($7.99), Radio, Slacker, and Rara (all $9.99). *See id.*

358. In this context, it is appropriate to examine effective revenue shares rather than effective per-play rates, which are more likely to vary according to business models, and the intensity of subscriber usage. The intensity of subscriber use (e.g., numbers of plays per month, which directly determines the effective per play rates) is likely to vary with the nature of the service offerings, the business model of the service, and the success of the service. Also, as noted, the parties to directly licensed agreements could have agreed to simple per-play rates but instead chose greater-of compensation structures which included per-subscriber minima and/or minimum percentages of revenue.

359. iHeart also points to an example comparing the licensing rate ratio of Rhapsody's interactive service as compared to its non-interactive unRadio service, purportedly to demonstrate that the ratio of licensing rates between the applicable rates for the services exceeds the 2.0 ratio of subscription rates. *See* IHM PFOF ¶ 281. But if one has a rate for a non-interactive service, which unRadio is, there is no need to apply *any* interactivity adjustment to the rate. As iHeart concedes, the unRadio example they give has a licensing rate of " *Id.* That rate is higher than SoundExchange's rate proposal, supporting and demonstrating its reasonableness.

360. iHeart's example also is flawed for several additional reasons. First, it exclusively looks at the *effective* per-play rates which, as discussed above, is improper in this context. iHeart's example also is an instance of cherry-picking. Prof. Rubinfeld's analysis focused on averages rather than individual data points. There will always be more variation when one looks at individual points compared to a market-wide average. Focusing on a single or limited set of agreements could give one a distorted, unrepresentative picture of the market data. To avoid that problem, Prof. Rubinfeld focused on market-wide averages.

361. And indeed, iHeart ignores data which is contrary to its example. For example, Beats has a minimum stated compensation per play of [redacted] in its agreement with Warner for its subscription service. *See* Hr'g Ex. SX-63 (Rubinfeld Corr. WDT, App. 1a). If one were to take that rate and compare it to Beats' "The Sentence" rate for Warner [redacted] (Hr'g Ex. SX-29 ¶ 183 (Rubinfeld Corr. WRT), that results in a ratio of [redacted], which is significantly *less* than the interactivity adjustment of 2.0.

c. The Removal Of Purportedly Non-DMCA Compliant Non-Interactive Services In The Interactivity Adjustment Ratio Would Make The Adjustment Smaller, And SoundExchange's Proposed Rates Higher

362. The Services argue that the inclusion of Rhapsody unRadio, Nokia MixRadio+, and Slacker RadioPlus on the "non-interactive" side of the subscription price ratio was improper because, although those services do not have "on-demand" functionality, they may have additional functionality that renders them non-DMCA compliant and ineligible for the statutory license. Pandora PFOF ¶ 264; NAB PFOF ¶ 371; IHM PFOF ¶ 315. The Services are wrong for two reasons.

363. First, because Prof. Rubinfeld was attempting to isolate the value of interactivity, and more specifically on-demand functionality, the fact that such services may have included

additional non-DMCA compliant functionality does not undermine the primary purpose of the exercise. Indeed, the additional functionality that the Services are complaining about was on the non-interactive side of the ratio – thus, if anything, including those services further isolated the value of on-demand functionality.

364. Second, and moreover, the Services' argument ultimately does not help their case. If one were to exclude these three subscription services from the ratio, the interactivity adjustment actually becomes *smaller* – with the resulting per-play rate *increasing*. Removing those services (Rhapsody unRadio at $4.99; Nokia MixRadio+ at $3.99; and Slacker RadioPlus at $3.99) from the non-interactive side of the ratio results in a new interactive-to-non-interactive ratio of $9.86/$5.24-$5.99, or an interactivity adjustment of 1.64 - 1.88, which is significantly less than the 2.0 adjustment Prof. Rubinfeld used.

d. The Interactivity Adjustment Should Not Apply To The Percentage-of-Revenue Prong

365. The Services argue that Prof. Rubinfeld erred in not applying the interactivity adjustment to the percentage-of-revenue prong. IHM PFOF ¶¶ 328-331. It would be inappropriate to apply a 2.0 adjustment to SoundExchange's proposed percentage-of-revenue prong of 55%.

366. Applying the adjustment to the percentage-of-revenue prong would be a form of double counting since non-interactive service revenues are already discounted by the differences in market prices between interactive and non-interactive subscription services. *See* Hr'g Ex. SX-17 ¶ 211 (Rubinfeld Corr. WDT); *see also* Hr'g Tr. 1814:8-13 (May 5, 2015) (Rubinfeld) ("I would be double counting, because the percentage of revenue is reflecting the intensity of use"); *id.* at 1818:12-24 (noting that applying ratio of 2:1 to percentage of revenue "would not be appropriate"). Since non-interactive services generate less revenue than interactive services per

user – indeed, at approximately a 2:1 basis with respect to subscription prices, which is the foundation of the interactivity adjustment to begin with – applying the same percentage already results in a lower royalty payment for them; discounting that percentage again would be double counting. *Id.* at 1819: 3-25 (going through example percentages and discounts to demonstrate double counting phenomenon and noting that 2:1 adjustment is "clearly inappropriate").

367. As an example, if an interactive service earns $10 per month per user, a 55% percentage-of-revenue prong would result in $5.55 to the labels. If a non-interactive service earns $5.00 per month per user, a 55% percentage-of-revenue prong would result in $2.75 to the labels – which is already more than 50% less than the amount obtained on the interactive side. Further discounting the $2.75 would be improper. It already reflects a discounted royalty rate.

368. And as noted in SoundExchange's Proposed Findings of Fact, several non-interactive service agreements have percentage-of-revenue prongs that are close to SoundExchange's rate proposal of 55%, and are nowhere close to a 2.0 adjustment to the 55% prong. *See* SX PFOF ¶¶ 427-430. (Rhapsody's agreements with Universal, Warner, and Sony for its unRadio service, which does not have on-demand functionality, [redacted]; the agreements between Universal, Sony, and Warner with Nokia for its MixRadio streaming service, which does not have on-demand functionality, [redacted]; Rdio's free radio service [redacted]

[redacted].]). The Services' argument largely ignores these agreements.

369. Acknowledging that the [redacted] in the iHeart-Warner agreement is inconsistent with this argument, iHeart attempts to run away from it, saying that it would never have become operative. IHM PFOF ¶¶ 331-332. [redacted].] Hr'g Tr. 7405:9-7406:3; 7415:1-18 (June 3, 2015) (Wilcox).

370. iHeart also notes that Warner's [redacted]." IHM PFOF ¶ 331. Of course, this does not mean that it was not possible for the prong to be triggered. The parties negotiated and included the [redacted] in the agreement for a reason, and there is no basis to simply assume that the provision is superfluous or has no value. Moreover, there is no evidence from either Apple or Sony that there was not a possibility that the [redacted]

e. Comparing Ad-Supported Services Supports An Even Smaller Interactivity Adjustment

371. The Services critique SoundExchange for failing to consider ad-supported services in calculating the interactivity adjustment. Pandora PFOF ¶¶ 265-267; NAB PFOF ¶¶ 361-370; IHM PFOF ¶¶ 282-284. Notwithstanding the fact that ad-supported revenue is less susceptible to isolating the value of interactivity, discussed in Section III.B.5.e, *infra*, Prof. Rubinfeld did address the issue of ad-supported services. He analyzed and compared the ARPU of ad-supported interactive and ad-supported non-interactive services. *See* Hr'g Ex. SX-29 ¶¶ 164-69 (Rubinfeld Corr. WRT), Hr'g Ex. SX-142 (Rubinfeld Corr. WRT Exs. 14A, 14B).

372. As noted in SoundExchange's Proposed Findings of Fact, the ARPU ratio for Spotify and Pandora for their ad-supported services for the period running from the third quarter of 2011 to the third quarter of 2014 is [ ]. Hr'g Ex. SX-29 (Rubinfeld Corr. WRT) ¶ 165, Hr'g Ex. SX-142 (Rubinfeld Corr. WRT Exs. 14A, 14B). For the third quarter of 2013 to the second quarter of 2014 – the period used in the calculations leading to SoundExchange's rate proposal – the ratio [ ]. *Id.* If one were to use this 2.0 factor to adjust rates from paid offerings only, and separately used [ ] to adjust rates from free offerings, the resulting weighted average benchmark rates would exceed the rates that SoundExchange proposed. *Id.*[17]

373. The Services do not dispute this, but instead argue that one should compare the mix of subscription and advertising revenue from the interactive and non-interactive services. In doing so, Prof. Katz derives an interactivity adjustment of 3.96 focusing on the average revenue per stream of interactive and non-interactive services. NAB PFOF ¶¶ 366-69; *see also* IHM PFOF ¶ 285.

374. But as described in SoundExchange's Proposed Findings of Fact, if one were to mix and compare revenues for subscription services and ad-supported services, that would mix apples-and-oranges, and these differences in business models could mask or distort the value of interactivity. Hr'g Ex. SX-29 ¶ 171 (Rubinfeld Corr. WRT); Hr'g Tr. 6307:2-6308:6 (May 28, 2015) (Rubinfeld). Prof. Katz's attempt to compare business models to one another fails to isolate and place a value on interactivity.

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[17] That certain interactive services may have lower price tiers for ad-supported services (IHM PFOF ¶ 287) does not undermine the interactivity adjustment, because if one isolates those tiers and compares just the ad-supported services, one has a 1:1 ratio and no further adjustment is necessary.

375. Whereas monthly subscription prices are largely constrained by market forces and are less sensitive to advertising, monetization, and content strategies, revenues for ad-supported businesses may largely be dictated by idiosyncratic strategies that determine the frequency and intrusiveness of ads as well as other policies (e.g., daily skip limits or listening limits). This problem becomes particularly pronounced when one is evaluating revenues on a stream basis, when Services have considerable discretion, dictated by strategic considerations, in determining how many performances there will be. As Prof. Rubinfeld notes, differences in such revenues may reflect differences in business models of the services and not differences that are solely reflective of the value of interactivity. Hr'g Ex. SX-29 ¶ 165 (Rubinfeld Corr. WRT). Katz's mixing of apples and oranges to come up with an interactivity adjustment of 3.96 masks the isolated value of interactivity that comes through subscription prices.

376. Likewise improper is Prof. Katz's attempt to derive an interactivity adjustment based on the *profitability* per stream. *See* Pandora PFOF ¶¶ 268; NAB ¶¶ 352-360, 379-387. Prof. Katz proposes an interactivity adjustment of 7.9 based on a comparison of interactive and non-interactive services' purported profits per stream. As Prof. Katz testified, central to his model was the assumption that the cost per play is the same for interactive services as it is for non-interactive services. *See* Hr'g Tr. 3101:1-7 (May 12, 2015) (Katz). This assumption was premised upon Pandora's non-licensing overall costs being 7.5 times greater than those of all the interactive services combined, such that Pandora's costs are equivalent to those of each interactive service on a per-play basis. *See* Hr'g Tr. 3101:14-17 (May 12, 2015) (Katz).

377. Prof. Katz did not examine any particular costs of an interactive service like Spotify to support his assumptions. *See, e.g.,* Hr'g Tr. 3110:1-5 (May 12, 2015) (Katz) ("Q. But you didn't look into how much Spotify has spent on its algorithm during that 12-month period,

correct? A. No, I did look into it. I didn't find data."). He acknowledged to the Judges that such an approach was "speculative." *Id.* at 3123:5-14 ("[JUDGE STRICKLER:] So my question is: If you don't have – if you can't make that allocation, how can we rely on Table 6 with regard to the interactive costs if we have no way of – you just made an assumption about cost and they were equal, but then you said, but Spotify, we just don't know, so I am just assuming costs are equal to noninteractive. That at first blush sounds kind of speculative. THE WITNESS: I will accept your characterization of that."). Moreover, he acknowledged that a service's profitability on a per-play basis, and in turn its revenues and costs on a per-play basis, could reflect the fact that services like Pandora may not be trying to maximize profits in the short term, but rather are focused on growing their user base. *See id.* at 3126:3-25. This renders relying on per-play profitability unreliable, because again, it may reflect individual business decisions and strategies rather than the market value of interactivity.

378. Focusing on profitability also raises the possibility that streaming services would have a disincentive to control costs, because they know that if their costs are higher – and thus profits are lower – the interactivity adjustment could be higher, and thus the royalty rate lower. *See* Hr'g Tr. 2861:14-22 (May 11, 2015) (Katz) ("JUDGE STRICKLER: Professor, if we were to focus on profits over revenues in that regard, and, therefore, we'd be looking at nonlicensing costs, doesn't that create a disincentive for services to control their costs, knowing that if their costs are higher, that as a consequence, the royalty rate would be lower? THE WITNESS: So I want to be careful about how I'm using one of the things.").

379. NAB now acknowledges that Prof. Katz's approach is wholly speculative, and has suggested a smaller discount, stating that his "intuition was correct." NAB PFOF ¶ 386. This, however, does not cure its defects; indeed, the entire exercise based on comparing costs and

profitability is hopelessly flawed and focuses on the wrong metrics which do not isolate the value of interactivity and which cannot reliably serve as an alternative interactivity adjustment.[18]

380. The Services' claim (NAB PFOF ¶ 370; IHM PFOF ¶¶ 297-298) that Prof. Rubinfeld failed to account for different numbers of performances per users between interactive and non-interactive users also is false, because he accounted for such differences through his 1.1 adjustment for differences in the number of royalty-bearing plays. As Prof. Rubinfeld notes in his testimony, this adjustment is to account for the fact that "different services may differ in the intensity of their listening during a month." Hr'g Ex. SX-17 ¶ 135 (Rubinfeld Corr. WDT).

f. The Interactivity Adjustment Is Conservative

381. The evidence presented in the written submissions and at the hearing has revealed that the hypothetical market statutory services would compete with other streaming services in the upstream market for licenses in the very same way they currently compete downstream for listeners. This fact renders an interactivity adjustment of 2.0 inherently conservative, if not overstated.

382. As discussed, in the hypothetical market, labels would negotiate licenses with services like Pandora to make them more equivalent to their competitors, including by negotiating revenue shares along with similar conversion incentives to maximize ARPU. *See, e.g.*, Hr'g Ex. SX-10 ¶ 16 (Harrison Corr. WDT) ("As revenue from streaming services becomes much more important to Universal's overall revenue, . . . [it has] become more deliberate than in prior years about the terms on which [it] will authorize the use of [its] repertoire for such purposes."); Hr'g Tr. 375:16-21 (Apr. 28, 2015) (Kooker) (moving listeners from lower ARPU offerings to higher

[18] NAB's reference to Prof. Rubinfeld's consideration of profitability (in addition to revenue) in his Nash bargaining model submitted to the FTC (NAB PFOF ¶ 382) is irrelevant. That exercise had nothing to do with isolating any value of interactivity; rather, it was focused on examining how the bargaining dynamics might change as a result of the proposed acquisition.

ARPU offerings is "critical" goal for Sony); Hr'g Tr. 2403:15-2404:8 (May 7, 2015) (Wilcox). Record companies therefore "would take the same approach" with statutory services like Pandora "[a]nd the structure of the deal would generally be the same." Hr'g Tr. 1080:17-24 (Apr. 30, 2015) (Harrison).

383. Given this, it is highly unlikely that labels would negotiate rates that are *half* of the rates interactive services pay. And indeed, the market evidence demonstrates that this would not be the case. As noted, Beats has a minimum stated compensation per play of [redacted] in its agreement with Warner for its interactive subscription service. *See* Hr'g Ex. SX-63 (Rubinfeld Corr. WDT, App. 1a). If one were to take that rate and compare it to Beats' "The Sentence" rate for Warner [redacted] (Hr'g Ex. SX-29 ¶ 183 (Rubinfeld Corr. WRT)), that results in a ratio of [redacted], which is significantly *less* than the interactivity adjustment of 2.0.

g. The Conjoint Survey Independently Supports The Interactivity Adjustment

384. Prof. McFadden conducted a conjoint survey to determine the value that future consumers of digital streaming services place on the features of those services. Specifically, Prof. McFadden determined the value that future consumers place on features that are not available under the statutory license, such as the ability to play tracks on-demand, the ability to listen to tracks "offline," and the ability to skip songs in an unlimited manner. Hr'g Ex. SX-15 ¶ 9 (McFadden WDT). The results of Prof. McFadden's conjoint corroborate and independently support the interactivity adjustment applied here.

385. The Services levy two primary attacks on the conjoint survey – that it failed to include all the proper service attributes, and that it was "confusing" to some respondents – neither of which has merit, as explained below.

i. Feature And Attribute Selection

386. The Services' claim that Prof. McFadden's feature selections were erroneous because he purportedly excluded relevant features (NAB PFOF ¶¶ 415-416; IHM PFOF ¶ 319) is misplaced. SoundExchange addressed these critiques in its Proposed Findings of Fact. *See* SX PFOF ¶¶ 411-415.

387. The Services focus on two attributes in particular (1) high audio quality, and (2) social networking functionality. NAB PFOF ¶¶415-416; IHM PFOF ¶ 319. As Prof. McFadden testified, there "is a trade-off in these studies between having extremely detailed lists of specifications and having somewhat arrogate or generic descriptions of specifications. There's a problem with presenting people with too much of a flood of specifications. That's a standard problem in market research and one where there are essentially standard recipes which say you cannot have too many different attributes." Hr'g Tr. 914:4-13 (Apr. 29, 2015) (McFadden). Accordingly, attempting to include every potentially relevant feature of a streaming service could have undermined the accuracy and reliability of the survey itself. *Id.*

388. Prof. Hauser made an identical point in response to criticisms that he did not include every possible smartphone feature attribute in his conjoint for Apple in the *Apple v. Samsung* litigation. As Judge Koh noted, quoting Prof. Hauser, in rejecting the claim that Prof. Hauser's survey itself was too long or complicated:

> Specifically, Samsung contends that Dr. Hauser's survey, in which he tests only six smartphone and tablet attributes, cannot be used to predict demand of an entire smartphone or tablet, both of which contain hundreds of features. The literature on conjoint analysis and the case law recognize that there are limitations on the number of distraction features that can be surveyed in a conjoint survey. *See TV Interactive Data Corp. v. Sony Corp.*, 929 F.Supp.2d 1006, 1025–26 (N.D.Cal.2013) (noting on a Daubert motion that "the literature on conjoint analysis condones testing six or fewer variables to produce research with a better predictive value" and that "long-standing peer reviewed literature [suggests] using six or fewer variables leads to better predictive results because survey

> respondents are not overwhelmed by too much data"). *Dr. Hauser himself has testified to this limitation of his survey.* Retrial Tr. at 523:17–25 (Q: "Okay. Did you include each and every possible other feature of a smartphone in your survey?" A: No. That would not be feasible." Q: "Why not?" A: "*Well, if I did, it would be a very difficult survey to take, and it's important there that the consumers do keep all the other features constant in their mind. And this is the way that we do it in the industry. It's a very accepted form of doing a conjoint analysis.*"). In fact, Samsung's expert's criticism is largely based on the premise that Dr. Hauser's survey was excessively complicated and too long. Implicit in this criticism is an acknowledgment that the scope of a conjoint survey must be limited. Reibstein Rep. ¶¶ 224–27 (criticizing complexity of Dr. Hauser's conjoint survey).
>
> Samsung's contention that the limitations of conjoint surveys with respect to the number of attributes that can be tested renders choice-based conjoint surveys unreliable is belied by the literature on conjoint surveys. Specifically, studies have demonstrated that conjoint surveys were adequately able to quantify consumer demand with respect to complex products such as HMOs and hotel chains.

Apple, Inc. v. Samsung Electronics Co., Ltd., Case No. 12–CV–00630–LHK, 2014 WL 794328, at *16-17 (N.D. Cal. Feb. 25, 2014) (emphases added).

389. But moreover, excluding these features, if anything, made the survey more conservative. If these features had been included, this would have only decreased, not increased, the resulting interactivity adjustment. That is because high audio quality and social networking functionality are features of *both* interactive and non-interactive streaming services. If one adds a value to both sides of a ratio, that makes the resulting ratio *smaller* (e.g., 8/4=2; 10/6=1.67).

390. As Mr. Fleming-Wood testified at the hearing, "[p]remium audio quality," at 192 kilobits per second (kbps) is offered through Pandora One, a non-interactive subscription service. Hr'g Tr. 6192:1-6 (May 27, 2015) (Fleming-Wood). Audio quality with a minimum of 192 kbps or higher is also offered through several non-interactive services or service tiers in addition to Pandora, such as Apple (256 kbps), and Rdio (192 kpbs). Hr's Ex. IHM 3646 at 2 (*Time*

Magazine, "13 Streaming Music Services Compared by Price, Quality, Catalog Size and More," March 19, 2014, relied upon by Prof. McFadden's team). Moreover, several interactive subscription services have comparable audio quality, such as Rhapsody (192 kpbs) and Xbox Music (192 kpbs). *Id.*[19]

391. Similarly, both non-interactive and interactive services offer social networking functionality. As Pandora's marketing video states,

> [b]ecause music is often a shared experience, Pandora listeners can share their stations with others. For example, listeners can click the Options button and make their stations visible to other listeners, find other listeners who like the same music, or associate their Pandora account with their Facebook account and share things such as what station they are listening to or what song they thumbed up.

Hr'g Tr. 6129:23-6130:6 (May 27, 2015) (Fleming-Wood). Similarly, Spotify also offers social networking integration in its product. *See* Hr'g Ex. IHM 3645 at 4 (Spotify "offers tight integration with Facebook"). Again, this is an example in which the missing attribute would be added to both sides of the ratio, thereby *decreasing* the resulting discount factor.

392. iHeart also suggests (IHM PFOF ¶¶ 321-324) that Prof. Rubinfeld erred in relying upon the catalog size feature attribute for a non-interactive premium service of "20 million songs, rather than approximately 1 million," because this is inconsistent with Pandora's own catalog size. This argument is incorrect, for at least two reasons. First, it's simply wrong. Prof. Rubinfeld relied on a catalog size of 1 million to 10 million songs for the premium non-

[19] Offering multiple tiers of audio quality attributes would have potentially been even more overwhelming for respondents, such as 128 kbps (Slacker), 192 kpbs (Pandora, Rdio, Xbox Music, and Rhapsody), and 256 kbps (Apple), and 320 kbps (Spotify, Beats, Google). Hr'g Ex. IHM 3646 at 2. And because interactive services and non-interactive services share the same levels of audio quality across the spectrum, it would have been impossible to break out levels of audio quality falling within the interactive vs. non-interactive bucket.

interactive service, not 20 million songs. *See* Hr'g Ex. SX-56 (Rubinfeld Corr. WDT, Ex. 14). Second, several statutory, non-interactive services have a catalog size far in excess of 1 million songs. For example, iHeart has a catalog size of 15 million and iTunes Radio has a catalog size of 26 million. *See* Hr'g Ex. IHM 3646 at 1-2. Indeed, Pandora is an outlier amongst non-interactive services in having a catalog size of only 1 million songs, and it would have been inappropriate to apply that catalog size as the relevant feature attribute for the hypothetical non-interactive premium service. *See also* Hr'g Ex. SX-17 ¶ 209 (Rubinfeld Corr. WDT) (noting that "playlist formation and catalog size were chosen to reflect typical services that may now exist in the marketplace.").

ii. Hauser Qualitative Survey

393. The qualitative survey from Prof. Hauser that the Services rely upon does not undermine the accuracy or integrity of Prof. McFadden's conjoint analysis.

394. The claim that the feature descriptions were confusing to respondents (NAB PFOF ¶¶ 417-419) is both overstated and at any rate irrelevant.

395. First, as demonstrated in SoundExchange's Proposed Findings of Fact (SX PFOF ¶¶ 417-424), Prof. Hauser acknowledged that a conjoint survey is supposed to replicate real-world decision making. *See* Hr'g Tr. 5592:1-5 (May 22, 2015) (Hauser) ("Q. . . . So, Professor Hauser, you agree, don't you, that conjoints are supposed to replicate real world decision-making; is that right? A. Yes, that's the goal."). The feature descriptions used by Prof. McFadden's survey that Prof. Hauser's survey purportedly found confusing are the precise terms used in the real world by streaming services. *Id.* at 5592:6-5599:7. And as Prof. Hauser acknowledged, consumers in the real world have various levels of expertise with respect to the features of streaming services at the time of purchase. *Id.* at 5598:18-22 ("Q. And you agree,

don't you, that in the real world consumers have different levels of expertise with respect to specific features of streaming services at the time of purchase? A. Oh, I absolutely agree.").

396. Prof. Hauser's survey thus demanded a higher level of feature comprehension than consumers have in the real world, belying the fundamental purpose of the conjoint survey, which is to replicate real-world decision making. As Prof. McFadden explained, "descriptions of features that we use are, as I described earlier, distilled from websites of the vendors of streaming services and from Internet comparisons of streaming services. The language here is – and the definitions are apparently relatively standard among the people who are consumers of these services. So I think there is a content validity to these descriptions quite independently of whether a person drawn into a survey would, when asked do they understand this language, expressed some difficulties with it." Hr'g Tr. 903:5-18 (Apr. 29, 2015) (McFadden).

397. As Judge Koh noted in the *Apple v. Samsung* litigation in rejecting a criticism of Prof. Hauser's conjoint survey features as not sufficiently tailored to the patent claim description, the

> Court does not agree with Samsung that Dr. Hauser's description of claim 20 is overbroad. In light of the purpose for which Apple will use this survey evidence at trial, the Court concludes that Dr. Hauser's description of claim 20 of the '414 Patent is sufficiently tailored to the requirements of that claim. The Court agrees with Apple that the accuracy of Dr. Hauser's survey question *must be evaluated from the perspective of a Samsung customer*. *See* Daubert Hearing Tr. at 118 ("The question the Court's trying to answer here is, ... were the benefits of claim 20 adequately captured *to the survey recipients*.") That perspective is appropriate because Dr. Vellturo uses Dr. Hauser's survey evidence to evaluate the demand that Samsung customers have for the technology of the asserted claim in Samsung's products.

2014 WL 794328, at *19 (emphasis added). As Judge Koh further noted in rejecting Samsung's criticisms of the features Prof. Hauser used and described, "Dr. Hauser selected the distraction features to be surveyed based on features *highlighted in Samsung's own manuals*." *Id.* at *24

n.10 (emphasis added). No different here, Prof. McFadden's conjoint was geared toward the real-world perspective of the streaming service consumer, and used feature descriptions directly from the Services' own marketing materials.

398. Prof. Hauser's survey also is not probative of respondents' understanding of the features of the survey, because it was simply a memory test which asked respondents to repeat what they had seen on a previous screen. As Prof. Hauser acknowledged, respondents were not presented with the language describing the incentive alignment or features when they were asked by his questioners to describe their understanding of them. *See* Hr'g Tr. 5600:16-21 (May 22, 2015) (Hauser) ("Q. My question was: At the time they are asked, what is their understanding of incentive alignment? They are not, at that point, looking at the screen which defines incentive alignment; is that right? A. Exactly."). The inability of a respondent to articulate back a precise understanding of what he or she previously read, however, does not mean that they do not sufficiently understand the feature for purposes of placing a willingness-to-pay value on it, as Prof. McFadden explained. *See* Hr'g Tr. 903:18-904:5 (Apr. 29, 2015) (McFadden) ("So I think, depending on how a question about do you understand something is asked, you can often have people say that, well, yes, I have a problem understanding in a situation where, in fact, in terms of actually making a decision on the basis of it, they don't have a problem with it at all. So I think one response that I have is that it's speculation that the rate of people who say they don't understand the verbal wording of the question would suggest that that translates into some kind of direct bias or error in people's responses."); Hr'g Ex. SX-2368 at 6-7 (McFadden Supp. WRT) ("Professor Hauser requires his subjects to engage in a memory test — to recall from memory or experience and verbalize definitions judged to be correct by Prof. Hauser's coders for each of the product features that I use in my survey. This cognitive task is quite different from the cognitive

task of evaluating product profiles, where the reliability of a survey simply requires that participants perform this task in a survey experiment similarly to the way they would in a real market.").[20]

399. Judge Koh similarly criticized one of Prof. Hauser's conjoint surveys in the *Apple v. Samsung* litigation as effectively creating a memory test scenario. As Judge Koh noted,

> Although Dr. Hauser described to respondents possible noninfringing alternatives to the patented features at the beginning of the survey, when presenting the 16 choice sets, Dr. Hauser *did not remind respondents that those noninfringing alternatives could replace the patented features.* Dr. Hauser could have easily done so by, for example, replacing the shorthand description of the patented feature (e.g., 'Rubberband') with a shorthand description of a noninfringing alternative.

Apple, Inc. v. Samsung Elecs. Co., Ltd., Case No. 11–CV–01846–LHK, 2014 WL 976898, at *14 (N.D. Cal. Mar. 6, 2014) (emphasis added).

400. Moreover, with respect to product features, Prof. Hauser vastly misrepresents the actual level of confusion reported even under his own flawed approach. In fact, 49 out of 53 respondents, or 92% of respondents, understood all but one or two of the product features in his survey. *See* Hr'g Ex. IHM 3145 (Hauser WRT Ex. 12).

401. Moreover, the claim that respondents did not understand the precise mechanics of the conjoint survey's incentive alignment (NAB PFOF ¶ 420) does not undermine the

[20] And in the context of consumer confusion, courts repeatedly have rejected these sorts of "memory tests" as flawed and not probative on the question of confusion. *See, e.g., Starter Corp. v. Converse, Inc.* 170 F.3d 286, 297 (2d Cir.1999) (affirming exclusion of survey that "was little more than a memory test, testing the ability of the participants to remember the names of the shoes they had just been shown and gave no indication of whether there was a likelihood of confusion"); *Instant Media, Inc. v. Microsoft Corp.*, 2007 WL 2318948, at *15 (N.D. Cal. Aug. 13, 2007) ("Microsoft's survey is little more than a 'memory test,' measuring how many respondents who had just read the source indicators 'Instant Media' and 'I'M' on a website could accurately recall them. Such a survey is useless in the Court's analysis in likelihood of confusion.").

effectiveness of the alignment. As SoundExchange has noted, Prof. Hauser's requirement of a precise understanding of exactly how the incentive alignment in the survey operated demanded a higher level of comprehension than what incentive alignments are intended to accomplish and the governing literature on this issue. As Prof. Hauser testified, the "goal of incentive alignment comprises three components: the respondents believe (1) it is in their best interests to think hard and tell the truth; (2) it is, as much as feasible, in their best interests to do so; and (3) there is no way, that is obvious to the respondents, they can improve their welfare by 'cheating.'" Hr'g Ex. IHM 3124 ¶ 19 (Hauser WRT).

402. That does not require people to understand the precise mechanics of how an incentive alignment operates, as Prof. McFadden has explained. *See* Hr'g Tr. 905:17-906:7 (Apr. 29, 2015) (McFadden) (incentive alignment "simply asks people to be careful and accurate in their responses" and example of how incentive alignment worked, that Hauser found confusion in, was "essentially an example which showed them it was in their economic interest to be truthful in their responses"). As Prof. McFadden has testified, the "real value of an incentive alignment mechanism is to focus participants on responding as they would in a real market. Even if comprehension isn't perfect, focusing the participants' minds on market choices using incentive alignment improves the accuracy of the responses." Hr'g Ex. SX-2368 at 5 (McFadden Supp. WRT). This same point is echoed by Prof. Din Ming, a leading expert on conjoint analyses and incentive alignments whom Prof. Hauser relies upon heavily in his own testimony[21]: the "'value of the [incentive alignment] mechanism may depend less on a respondent's understanding why it works or liking how it works and more on a simple alignment

[21] As Prof. Hauser stated in his written testimony, "I have co-authored papers with Min Ding in which we used incentive alignment. I have discussed the challenges of incentive-alignment at length with Min Ding." Hr'g Ex. IHM 3124 at 37, n.73 (Hauser WRT).

of what happens in a conjoint exercise with what happens in the marketplace.'" *Id.* (quoting Songting Dong, Min Ding, and Joel Huber, "A Simple Mechanism to Incentive-Align Conjoint Experiments" *International Journal of Research in Marketing* Vol. 27, p. 30 (2010).).

403. The Services' claim that Prof. McFadden's pretest methodology was not sufficient (NAB PFOF ¶ 423) is baseless. As Prof. McFadden explained in his testimony:

> The nine respondents were asked whether they understood the choice tasks generally and whether there were any attributes that they considered important that they had not been asked about. The nine respondents were all familiar with music streaming services and they did not identify any attributes other than those that they had been asked about as important to them in choosing among streaming music services. This reaction indicates that the survey study design captures the features that distinguish streaming music services in the marketplace in the minds of consumers. In addition, none of these pilot participants stated that they had become bored with the presentation of the choice tasks or found the survey too lengthy. Based on their responses, however, I simplified the description and number of levels of the playlist attributes and simplified the language about incentives.

Hr'g Ex. SX-15 ¶ 41 (McFadden WDT). Prof. McFadden in his pretest found that respondents did not identify any features which they thought were missing, nor did any respondents find the survey too lengthy or boring. He also simplified certain language in response to his questions, which is standard practice in conducting conjoint surveys.

404. And it must be emphasized again that Prof. Hauser did not report to the Judges survey answers by respondents which demonstrate a high level of respondent understanding to the survey.[22] Amongst other questions, Prof. Hauser does not discuss one of his "close out"

[22] It appears that Prof. Hauser's recollection of which questions he did and did not code may be incorrect. Prof. Hauser testified that they coded 1-36, and beyond that, "We ran out of time in coding. That's all." Hr'g Tr. 5635:7-8 (May 22, 2015) (Hauser). A further review of his backup shows that, at least for video coding, Prof. Hauser did not go in sequential order. He did not code questions 10, 14, 23, 29, 32, or 33, all of which went to the level of understanding of the survey and respondents' decision-making process.

questions, which asks participants, "did you or did [you] not understand the explanations of features in the survey?" Prof. McFadden has reviewed his classifications of the participants, and he "records 84.9% of participants self-reporting that they understood the features discussed in the choice sets, while 11.3% report not understanding all the features, and 3.8% give answers that are ambiguous." Hr'g Ex. SX-2368 at 6 (McFadden Supp. WRT).

405. As Prof. McFadden explains, this "question gives insight into whether the participants themselves believed that they understood the features sufficiently to choose among the options," and that a "participant may not fully understand every feature, but may understand enough to weigh the choices, especially when the uncertain features are not relevant to his decision making." Hr'g Ex. SX-2368 at 6-7 (McFadden Supp. WRT). Unlike Prof. Hauser's "memory test" approach, this question demonstrates "that the participants generally believed that they had sufficient information and understanding to choose their preferred plans from among those presented." *Id.* at 7.

406. Similarly, Prof. Hauser did not report to the Judges the responses to Question 34, which asked his respondents, "if you were presented with these options and had to spend your own money, would you choose the same options?" in which he finds that 83% of respondents say that they would make the same choices, 13.2% state that they would make different choices, and 3.8% of the responses are ambiguous. Hr'g Ex. SX-2368 at 4 (McFadden Supp. WRT). As Prof. McFadden explains, the "responses to [this question] indicate that the incentive alignment in my survey was robust and effective. The essential feature of incentive alignment in conjoint surveys is to induce truthful responses," and "there is substantial evidence that response quality is not degraded so long as respondents respond to instructions to pay attention and choose as they

would in a real market, even if they do not understand specifically how the incentive alignment operates." *Id.* at 5.

407. Finally, Prof. Hauser's claim that the drop-out rate was too high in Prof. McFadden's survey (NAB PFOF ¶ 424) is belied by the record evidence. First, with respect to adults, Prof. Hauser found a drop-out rate of 17% rate, or 83% of respondents starting and completing Part B of the survey (the actual part of the survey that was the focus of Prof. Hauser's qualitative survey). *See* Hr'g Tr. 5630:7-16 (May 22, 2015) (Hauser). Prof. Hauser's own prior surveys have had drop-out rates of between 10-20%. *See* Hr'g Tr. 5632:3-9 (May 22, 2015) (Hauser). And although there was a higher drop-off rate with respect to teens, notably Prof. Hauser never claims that excluding the teens from the survey would have had different results upon the ultimate outcome of the survey. *See* Hr'g Tr. 900:21:-901:3 (Apr. 29, 2015) (McFadden) ("I can tell you that, in my judgment, what's going on with teens in this survey had no substantive impact on the final results").

h. Rubinfeld Properly Applied The Conjoint Survey Results

408. The Services' claim that there is "no relationship" between the average willingness-to-pay values in Prof. McFadden's conjoint survey results and the subscription prices (NAB PFOF ¶¶ 429-430) misses the point of the conjoint survey and is irrelevant. Prof. Rubinfeld is not using the willingness to pay values to approximate the subscription prices, but rather is using the willingness to pay values to corroborate the value of interactivity, which both approaches are attempting to do albeit through distinct methods. *See* Hr'g Ex. SX-17 ¶¶ 209-10 (Rubinfeld Corr. WDT). Moreover, this argument ignores that monthly subscription prices are largely constrained by market forces given the intense competitiveness of the downstream consumer market, and therefore there is a close relationship between consumers' demand

elasticities and their willingness to pay, and the actual subscription prices in the marketplace. *See supra* III.B.5.a.

409. Moreover, in response to NAB's argument (NAB PFOF ¶ 431), it was proper for Prof. Rubinfeld to reply upon average, as opposed to individual, willingness to pay values. *See* Hr'g Tr. 1878:8-1879:14 (May 5, 2015) (Rubinfeld). This is because although there is "heterogeneity in the answers of respondents of Dr. McFadden's conjoint study that would suggest different willingnesses to pay," those "individual estimates are not statistically significant," and when you rely on averages, you "get much more statistically reliable results." *Id.*

C. A Greater-of Structure Reveals And Does Not Distort Market Incentives And Will Not Deter Innovation

410. NAB contends that the greater-of structure will distort economic incentives and deter technological innovation. *See* NAB PFOF ¶¶ 552-554. These arguments have no evidentiary or economic foundation.

411. First, this argument ignores that nearly every major streaming service has a greater-of structure in its licensing agreements, including Spotify, Apple, iHeart, and Pandora. *See* SX PFOF ¶¶ 320-331. There is no evidence that these companies' inclusion of a greater-of structure in their licensing fees has at all deterred any technological innovation. To the contrary, companies like Apple and Spotify are considered technological leaders in the field.

412. Second, as demonstrated in SoundExchange's Proposed Findings of Fact (SX PFOF ¶¶ 332-340), a greater-of compensation structure provides economic benefits to both licensors and licensees, provides a reasonable sharing of the benefits of licensing among interested parties, and has positive economic efficiencies. *See* Hr'g Tr. 1756:21-1758:16 (May 5, 2015) (Rubinfeld).

413. The greater-of structure ensures that the recording companies providing the primary input to streaming services – the recordings themselves – are compensated reasonably, irrespective of the commercial success of the licensed service. Hr'g Ex. SX-17 ¶ 96 (Rubinfeld Corr. WDT). The per-play branch provides a guaranteed minimum payment per stream, compensating the record company for the usage of music even if the service earns low revenues or otherwise fails to monetize the use of music effectively. *Id.* The additional branch proposed here – a percentage of revenue – ensures that record companies will share in any potentially substantial returns that may be generated by services that succeed in the marketplace.

414. Because the greater-of formula proposed as part of SoundExchange's rate proposal does not include either a per-subscriber or per-user minimum fee and/or an overall minimum compensation guarantee – which is common in marketplace agreements – it is inherently conservative as compared to marketplace rates. Hr'g Ex. SX-17 ¶ 97 (Rubinfeld Corr. WDT).

415. The minimum per-play rate floor offers benefits to both record companies and services. For record companies, it provides them with a minimum reasonable return on their recordings and provides some compensation for the loss of the right to limit or exclude others from the use of their recordings, which they ordinarily would be entitled to in a market without a statutory license. Hr'g Ex. SX-17 ¶ 104 (Rubinfeld Corr. WDT). Streaming services also benefit from a greater-of structure with a percentage-of-revenue prong, because it allows the minimum per-play rate to be reduced, which would be the operative prong before a company obtains larger revenues triggering the percentage-of-revenue prong. *Id.* ¶ 95. This would reduce the costs and risks of entry by new services and if anything spur innovation by enabling new entrants to the market with lower costs. *Id.*

416. Conversely, a pure per-play rate could create distortions in the marketplace. For example, a per-play rate that is not sufficiently high could preclude record companies' benefiting from the contribution of their content to the success of a mature and successful business. Hr'g Ex. SX-14 ¶¶ 68-69 (Lys Corr. WDT). By contrast, if a rate were set too high, this could protect mature streaming businesses against new entrants.

417. The greater-of formula with a percentage-of-revenue prong further enables a beneficial form of price discrimination that can actually foster greater technological innovation. Hr'g Ex. SX-17 ¶ 112 (Rubinfeld Corr. WDT). All else being equal, services facing relatively low price elasticities will charge higher prices and generate greater revenues, and thus, those services are likely to pay on the percentage-of-revenue branch. *Id.* Conversely, those services facing relatively high price elasticities will, other things equal, charge lower prices and generate lower revenues, and thus are likely to pay royalties on a per-play basis. *Id.* Again, this structure will favor smaller streaming services, who may be best positioned to introduce innovation into the streaming services market.

418. Finally, NAB's claim that a greater-of structure will undermine business incentives and innovation is further belied by NAB's own proposed finding that "webcasters have plenty of incentive to remain successful, or they will go out of business." NAB PFOF ¶ 597.

D. A Percentage-of-Revenue Is Both Consistent With The Market And Appropriate Here

1. Revealed Preference In Interactive And Non-Interactive Spaces for Percentage-of-Revenue Prong

419. SoundExchange's revenue prong of the greater-of structure is supported by substantial record evidence and is economically warranted. The Services' arguments to the contrary are without merit.

420. NAB claims that the greater-of structure and revenue share prong is an artifact of market power in the interactive streaming market (NAB PFOF ¶ 601), yet this ignores the fact that non-interactive service agreements that Prof. Rubinfeld and the other experts in this case have analyzed also have greater-of structures with percentage-of-revenue shares.(*see* SX PFOF ¶¶ 325-331), including the following:

- The Apple iTunes Radio agreements with [. Hr'g Ex. SX-2070 at 1-2, section 1(b) (Apple-Warner Agreement); Hr'g Ex. SX-2071 at 2, section 1(d) (Apple-Sony Agreement).
- The Warner-iHeartMedia agreement contains a greater-of structure that includes a pro-rated share of [.] Hr'g Ex. SX-33 at 15-16, section 3(b)(ii). .] Hr'g Tr. 7405:9-7406:3; 7415:1-18 (June 3, 2015) (Wilcox).
- iHeartMedia's agreements with 27 independent labels also [;] also included, .] Hr'g Ex. SX-29 ¶ 87 (Rubinfeld Corr. WRT); Hr'g Ex. IHM 3343 at 9; Hr'g Ex. IHM 3365 at 11; Hr'g Ex. IHM 3356 at 9-10.
- The agreements between Universal, Sony, and Warner with Nokia for its MixRadio streaming service, which does not have on-demand functionality, .] Hr'g Ex. SX-29 ¶ 90 (Rubinfeld Corr. WRT). Hr'g Ex. SX-80]; Hr'g Ex. SX-87]; Hr'g Ex. SX-100
- Likewise, Rhapsody's agreements with Universal, Warner, and Sony for its unRadio service, which does not have on-demand functionality, has a greater-of structure with percentage-of-revenue shares. [

[redacted]

- The Pandora-Merlin agreement also includes a greater-of structure with a [redacted]. Reflecting the terms of the Pureplay agreement (which as described separately in SoundExchange's Conclusions of Law and below makes the Pandora-Merlin agreement an improper benchmark), the agreement provides [redacted]. Hr'g Ex. PAN 5014 section 3(e). Merlin believed at the time it signed the Pandora-Merlin agreement [redacted] Hr'g Tr. 6896:3-6899:3 (June 1, 2015) (Lexton).

421. NAB also reiterates the claim the parties to the non-interactive agreements may not have expected the revenue prongs to be operative. But as noted with respect to iHeart-Warner, [redacted]. Moreover, the widespread adoption of revenue prongs demonstrates that parties freely enter into these agreements without a clear knowledge which prong will be operative at the time they entered into the agreement, but that does not mean that the prongs are not valuable to the parties and reveal a market preference for such prongs.

422. NAB also argues (NAB PFOF ¶¶ 604-05) that almost no simulcast agreements have a greater-of structure, but that ignores [redacted]

2. The Percentage of Revenue Reflects Proper Risk Allocation

423. The Services also raise several arguments relating to the proper allocation of risk under the greater-of structure. None of these has merit.

424. First, NAB argues that the greater-of structure ignores the non-musical contribution involved with simulcasting (NAB PFOF ¶¶ 555-57), but this ignores the fact that SoundExchange's percentage-of-revenue prong will only take into account revenues that are attributable to streamed musical performances. As discussed elsewhere, SoundExchange has proposed a reasonable methodology for accomplishing that task. *See infra* at III.D.3.

425. NAB also focuses on the incremental value offered by various services (NAB PFOF ¶¶ 593-99). This argument disregards that although both record companies and streaming services will face uncertainty and risk in the future with respect to the variability of consumer demand, that risk is greater for the record companies, because they do not have the option of refusing to license, while services have the option of adopting, or not adopting, the statutory license rates. Hr'g Ex. SX-17 ¶ 100 (Rubinfeld Corr. WDT). The greater-of formula accounts for this risk asymmetry by ensuring that involuntary licensors – the record companies – receive at least a minimum payment per play in return for creating the recordings that generate the financial rewards flowing to the streaming industry. Hr'g Ex. SX-17 ¶ 102 (Rubinfeld Corr. WDT). It also allows rights owners to be compensated for a reasonable share of the revenues that are generated by successful services. *Id.* In the absence of a greater-of formula, a rate proposal premised solely on a per-play rate would not allow record companies to share in the upside benefits services obtain – a common feature of real-world agreements – thereby not capturing the entire value that record companies receive in the real world through their direct license agreements. *Id.* ¶ 103; *see also* Hr'g Ex. SX-14 ¶¶ 71-75 (Lys Corr. WDT).

426. And as discussed, this argument also ignores the benefits to streaming services from a greater-of structure. It allows the minimum per-play rate to be reduced, which would be the operative prong before a company obtains larger revenues triggering the percentage-of-

revenue prong. Hr'g Ex. SX-17 ¶ 95 (Rubinfeld Corr. WDT). This would reduce the costs and risks of entry by new services. *Id.* A pure per-play rate in this context could distort the market. It would not only preclude record companies from benefiting from the contribution of their content to the success of a mature and successful business, but if a rate were set too high, this could protect mature streaming businesses against new entrants. Hr'g Ex. SX-14 ¶¶ 68-69 (Lys Corr. WDT).

3. SoundExchange's Definition Of Revenue Is Appropriate And Workable

427. In its Proposed Findings of Fact, SoundExchange describes how the evidence supports its proposed revenue definition. SX PFOF ¶¶ 431–39. Prof. Lys's analysis of voluntary agreements shows that nearly all agreements contain some form of revenue sharing and that most agreements contain a "broad 'catch all' term that is designed to capture all the various types of income that could be earned by a service." Hr'g Ex. SX-14 ¶¶ 26–27, 30 (Lys Corr. WDT); SX PFOF ¶ 431. And Ron Wilcox testified that WMG's agreements "generally define 'revenue' [redacted] Hr'g Ex. SX-22 at 12 (Wilcox WDT); SX PFOF ¶ 432. Similarly, [redacted] under the Pandora – Merlin agreement to include [redacted]. H'rg Ex. PAN 5014 ¶ 1(n); SX PFOF ¶ 433.

428. SoundExchange also addressed objections raised by Prof. Weil regarding the allocation of revenues between business activities. SX PFOF ¶¶ 437–39. Prof. Weil admitted that accountants are "often" called upon to allocate revenues between business activities and that there are accounting principles to guide such allocations. Hr'g Tr. 3955:3–8 (May 14, 2015) (Weil). And although Prof. Weil testified that there is no "uniquely correct way to allocate

revenues between a company's business activities," he admitted that by use of the phrase "uniquely correct" he meant that there are many approaches to allocation, but no reason to pick on over the other. *Id.* at 3954:18–21.

E. Prof. Rubinfeld's Interactive Benchmark Calculations Were Reliable And Conservative

429. The Services lob a handful of attacks at the means by which Prof. Rubinfeld derived a rate proposal from the interactive service agreements. IHM PFOF ¶¶ 311-316, 328-333; NAB PFOF ¶¶ 361-387, 406-409, 433-439, 541-550; SXM PFOF ¶¶ 65-68. None of these groundless attacks undermine the reliability of Prof. Rubinfeld's analysis, which derived a statutory rate for 2016-2020 by conservatively calculating and adjusting the consideration received by record companies under their most recent agreements with 13 directly licensed, non-statutory services. *See* SX PFOF ¶¶ 374-399.

1. iHeart Misrepresents Prof. Rubinfeld's Analysis

430. iHeart charges that Prof. Rubinfeld's reliance on a purportedly "unreliable and biased" data set renders his benchmark analysis "uninformative." IHM PFOF ¶ 311. But iHeart fails to support this bluster with any legitimate examples of unreliable or biased data. Instead, it makes a series of misleading—and misinformed—statements about Prof. Rubinfeld's analysis.

431. First, iHeart asserts that "many of the interactive service agreements on which Professor Rubinfeld relies contain [redacted] that constitute a material portion of total compensation under the contracts." iHeart PFOF ¶ 313. This is simply not true. In reality, only [redacted] of the 26 agreements that Prof. Rubinfeld relied on for his benchmark rate calculation contained any [redacted] (those between the three major labels and [redacted]), and for these few agreements that contained such payments, it was a very small portion of the total

compensation under the agreements. Hr'g Ex. SX-59 (column titled [redacted]).

432. iHeart takes issue with Prof. Rubinfeld's use of performance data to allocate the value of the [redacted] in these three [redacted] agreements on a per-play basis over the course of the agreement. IHM PFOF ¶ 312. As an initial matter, iHeart fails to explain how Prof. Rubinfeld could have possibly performed a reliable expectations analysis given that [redacted] internal expectations were unavailable. In any event, even if the parties' projections had been available—and even if such projections varied from the performance data that Prof. Rubinfeld relied upon—an expectations-based analysis of such a [redacted] could not have substantially changed the outcome of Prof. Rubinfeld's final calculation. We know this is the case because the effect is small even when the payments are removed from the analysis *entirely*.

433. The "Weighted Average Minimum Per Play Rate" column in the table that summarizes Prof. Rubinfeld's calculations shows the effect of excluding the value of the [redacted] in the [redacted] agreements. *See* Hr'g Ex. SX-59. As reflected in that column, the weighted average minimum per-play rate stated in the interactive service agreements, before adding the [redacted], was [redacted] (the simple average was [redacted]). Applying Prof. Rubinfeld's adjustments to this weighted average yields a rate of [redacted]. Adding Prof. Rubinfeld's $0.00008-per-year escalation would result in a proposed per-play rate of $0.0024 for 2016, $0.0025 for 2017 and 2018; $0.0026 for 2019; and $0.0027 for 2020. Hr'g Ex. SX-17 ¶ 137. The rates derived from this calculation

show that SoundExchange's proposed rates are eminently reasonable (and far more reasonable than iHeart's).

434. The first error in iHeart's harangue against Prof. Rubinfeld's use of performance data is compounded by what appears to be a fundamental confusion as to how Prof. Rubinfeld calculated his benchmark-adjusted rates. iHeart suggests that Prof. Rubinfeld should have revised his rate proposal because he observed in his written rebuttal report that there had been a decline in effective per-play rates after the submission of his written direct testimony. IHM PFOF ¶¶ 313-314. iHeart chides Prof. Rubinfeld for failing to "provide a current average effective per-performance rate for interactive services to which his interactivity adjustment could be applied." IHM PFOF ¶ 314.

435. Respectfully, this criticism makes no sense. In analyzing the interactive service agreements for purposes of his rate proposal, Prof. Rubinfeld did not apply his interactivity adjustment to the *effective* per-performance rates for interactive services. SX PFOF ¶ 377. Instead, he relied solely on the *stated minimum* per-play rates in the agreements. *Id.* These minimum per-play rates stated in the agreements never change—they hold constant regardless of how the services perform. Hr'g Ex. SX-29 ¶ 248 (Rubinfeld Corr. WRT); Hr'g Tr. 1823:17-22 (May 5, 2015) (Rubinfeld). Changes in the *effective* per-performance rates therefore would have had no effect whatsoever on the agreements' average *stated minimum* per-play rates and no effect whatsoever on Prof. Rubinfeld's benchmark calculations. The only possible way Prof. Rubinfeld could have revised his rate proposal to reflect the changes in the "effective per-performance rates" is by replacing his conservative benchmark analysis based on the minimum per-play rates with a rate proposal based on the agreements' higher effective per-play rates. SX

PFOF ¶ 377. Such a revision would have resulted in an *upward* adjustment to Prof. Rubinfeld's rate proposal.

2. NAB's Critiques Of Prof. Rubinfeld's Conservative Revenue-Weighting Approach Do Not Withstand Scrutiny

436. SoundExchange showed in its Proposed Findings of Fact that Prof. Rubinfeld's use of revenue-weighting to calculate the average minimum per-play rates in the interactive service agreements was a conservative approach that properly measured the market average. SX PFOF ¶¶ 393-394; Hr'g Tr. 1822:1-16 (May 5, 2015) (Rubinfeld). Prof. Rubinfeld eschewed reliance on the far higher simple average, a number that arguably distorts the market landscape by giving small, relatively inconsequential services equal weight as dominant players [redacted]. *Id.*; Hr'g Tr. 1825:6-11 (May 5, 2015) (Rubinfeld) [redacted].

437. While weighting by streams is one potential means by which to give greater weight to those services that play a more significant role in the market, stream-weighting is an imperfect approach because a service's number of streams does not necessarily correspond with its market significance. SX PFOF ¶¶ 395-396; Hr'g Tr. 1828:10-20 (May 5, 2015) (Rubinfeld). For example, a service might offer a lot of ad-free listening or free trials that draw heavy usage but generate no revenue, or a service might simply fail to attract many advertisers or subscribers to fund its plays. *Id.* In each of these scenarios, the low-revenue-generating plays do not represent the long-term equilibrium of the market. SX PFOF ¶¶ 395-306. Stream-weighting therefore does not accurately capture services' relative roles in the market; accordingly, it is more likely to yield biased estimates of the market average. *Id.* Revenue-weighting, by contrast,

is a more reliable measure of the minimum per-play rates that will prevail over the long term in the marketplace. *Id.*

438. Based on its claim that Prof. Rubinfeld's revenue-weighting approach was somehow systematically biased, NAB maintains that stream-weighting would have been more appropriate. NAB PFOF ¶¶ 373-378. Its purported evidence of revenue-weighting's "systematic bias" is (i) a hypothetical example from Prof. Katz, and (ii) the fact that the stream-weighted average happened to be slightly lower than the revenue-weighted average for this particular dataset. *Id.* But Prof. Katz's hypotheticals and the averages in this particular case do not necessarily mean that revenue-weighting has an inherent upward bias. It doesn't. Neither weighting approach is inherently biased to provide higher or lower results than the other.

439. A simple adaptation of the hypothetical from Prof. Katz's demonstrative (NAB PFOF ¶ 375) shows that in some instances Prof. Katz's stream-weighting approach would yield higher average rates than revenue-weighting:

Service	Number of Plays	Subscription Price	Royalty Per Play	Number of Subscribers	Total Revenues
A	1 million	$5	$0.01	10,000	$50,000
B	1 million	$10	$0.02	2,000	$20,000

440. As in Prof. Katz's hypothetical, both Service A and Service B have the same number of total plays. Service A charges $5 for a subscription; Service B charges $10 for a subscription. The higher retail price for Service B would likely correspond with a proportionally higher royalty per-play. Hr'g Ex. SX-29 ¶ 172 (Rubinfeld Corr. WRT). In this hypothetical,

Service A has a lot of relatively low-intensity subscribers—in other words, a large number of subscribers that do not use the service very frequently. Service B, on the other hand, does not have as many subscribers at the $10 price point, but each of its subscribers use the service often and generate the same number of total plays as Service A.

441. Under Prof. Rubinfeld's revenue-weighted approach, Service A, which pays a lower per-play rate but plays a more meaningful role in the market, would be weighted more heavily than Service B. Hr'g Tr. 1828:18-20 (May 5, 2015) (Rubinfeld). Prof. Katz's approach, on the other hand, would give the services equal weight because of their equal number of plays. NAB PFOF ¶ 375. This would result in a *higher* average royalty than Prof. Rubinfeld's revenue-weighting approach. NAB's accusation of "systematic upward bias" therefore ultimately rings hollow.

442. Moreover, this example once again demonstrates that Prof. Rubinfeld's revenue-weighting approach is a more meaningful measure of the market average. Service B—the higher-priced, less successful service—would inevitably be driven out of the market in the long run. For purposes of calculating a market average, it makes little sense to place equal weight on a service that will not be a viable going concern. SX PFOF ¶¶ 395-396; Hr'g Tr. 1828:18-20 (May 5, 2015) (Rubinfeld).

3. Pandora Performance Data Confirms Propriety Of Prof. Rubinfeld's Royalty-Bearing-Plays Adjustment

443. With respect to Prof. Rubinfeld's 1.1 adjustment factor to account for the slightly higher number of royalty-bearing plays on statutory services, NAB contends that Prof. Katz used Pandora performance data to "compute a more accurate adjustment factor." NAB PFOF ¶¶ 406-409. SoundExchange showed in its Proposed Findings of Fact that this adjustment factor that NAB purports to be "more accurate" is unreliable because Prof. Katz failed to account for the

pre-72 recordings that Pandora treats as non-compensable under the statutory license. Hr'g Ex. PAN 5022 at 30 (Shapiro WDT); Hr'g Ex. SX-17 ¶ 213 (Rubinfeld Corr. WDT). In other words, Prof. Katz's one-sided analysis looked only at those performances that would make the adjustment factor larger. A proper comparison would capture the *net* differential in the number of royalty-bearing-plays on a statutory service (which pays for skips, but not pre-72 performances) as compared to directly licensed services (which do not pay for skips, but do pay for pre-72 performances). Hr'g Ex. SX-17 ¶¶ 212-214 (Rubinfeld Corr. WDT).[23] Properly analyzed to account for the treatment of both skips *and* pre-72 recordings, Pandora's performance data confirms the reasonableness of Prof. Rubinfeld's 1.1 adjustment factor. SX PFOF ¶¶ PFOF 387-390.

444. iHeart's attack on Prof. Rubinfeld's royalty-bearing-plays adjustment is perhaps even more misguided. IHM PFOF ¶ 316. iHeart contends that it is "far from clear" that Prof. Rubinfeld's estimated number of royalty-bearing plays on non-statutory services was proper. *Id.* Prof. Rubinfeld estimated the average number of royalty-bearing plays on a non-statutory service by making a few reasonable assumptions about the average length of a song (3.7 minutes), the number of ads per hour (3), the number of skips per hour (6), and the average length of a skip (15 seconds). Hr'g Ex. SX-57. After subtracting for ad-time and skips, he divided by the average length of a song. *Id.* The net result of this analysis was an estimate of 15 royalty-bearing plays per hour on a non-statutory service. *Id.*

[23] The 1.1 adjustment factor that Prof. Rubinfeld calculated in his written direct testimony properly accounted for Pandora's treatment of pre-72 recordings because he derived his estimate of Pandora's number of royalty-bearing-plays from Pandora's royalty payments, which by their very nature incorporate Pandora's treatment of both skips and pre-72 recordings. *See* Hr'g Ex. SX-58.

445. iHeart appears to be skeptical of this result because it relies on Prof. Rubinfeld's assumption that the directly licensed service would average six skips per hour. IHM PFOF ¶ 316. It insists that this was an "unreasonable assumption" because many interactive services provide their users unlimited skips. *Id.* This argument entirely misses the point. The royalty-bearing-plays adjustment—calculated by dividing the number of royalty-bearing-plays on a statutory service by the number of plays that would be royalty-bearing on a directly licensed service—is intended to make the per-play payments made by directly licensed services comparable to those that would be made by a statutory service. Hr'g Ex. SX-29 ¶ 214 (Rubinfeld Corr. WDT); Hr'g Tr. 1804:10-1805:9 (May 5, 2015) (Rubinfeld). It ensures that the statutory services' per-play payments do not constitute a disproportionate percentage of their revenue.[24] *Id.*

446. That a directly licensed service might allow unlimited, non-royalty-bearing skips is irrelevant for the purposes of such an analysis. The reason is simple: DMCA-compliant services generally limit users to six skips per hour. Hr'g Ex. SX-29 ¶ 214 (Rubinfeld Corr. WDT). A statutory license would therefore not have to pay for more than the six skips permitted on its service; any additional non-royalty-bearing skips that may be made on directly licensed services would simply not exist on the statutory service. In other words, while a directly licensed service might have more than six non-royalty-bearing skips per hour, a statutory service would

[24] Confusingly, both NAB and iHeart claim that Prof. Rubinfeld "failed to account for the likelihood that the number of performances per user differs between interactive and noninteractive services." NAB PFOF ¶ 370; IHM PFOF ¶¶ 297-98. Both Services seem to fail to grasp that accounting for differences in the services' intensity of use was the very purpose of Prof. Rubinfeld's royalty-bearing-plays adjustment. Hr'g Ex. SX-29 ¶ 214 (Rubinfeld Corr. WDT); Hr'g Tr. 1804:10-1805:9 (May 5, 2015) (Rubinfeld). The notion that Prof. Rubinfeld did nothing to "account for any differences in the number of plays" is plainly false—he devoted an entire section of his report to the exercise, and the application of the adjustment is evident throughout his appendices. NAB PFOF ¶ 370.

not pay for more than six of those skips. Because any non-royalty-bearing skips beyond the six assumed by Prof. Rubinfeld's analysis would not translate to any additional royalty-bearing plays on the statutory service, such skips would have no meaningful effect on the royalty-bearing-plays ratio. SX PFOF ¶ 997.

447. Even if iHeart's argument was not confused conceptually, it would get them nowhere. While unlimited-skips functionality is available on some tiers of some directly licensed services, others place limits on the numbers of times its users may skip songs. *See, e.g.,* SX-80 ([redacted]). iHeart also fails to consider that not all of the unlimited skips that are authorized by directly licensed services are necessarily non-royalty-bearing. Hr'g Tr. 1808:19-1809:10 (May 5, 2015) (Rubinfeld). An assumption of six non-royalty-bearing skips per hour on directly licensed services would therefore by no means be an unreasonable one.

448. In any event, even if iHeart were correct that directly licensed services averaged more than six non-royalty-bearing skips per hour, the underestimate would be counterbalanced by Prof. Rubinfeld's assumption that the directly licensed service would average three minutes of ads per hour. Hr'g Ex. SX-57. Any subscription service offering unlimited skips to its users would—by definition—not be ad-supported. Hr'g Ex. SX-56. The three minutes of ads assumed by Prof. Rubinfeld would therefore more than make up for any additional skips on an ad-free subscription service. These three minutes would allow for up to 12 additional 15-second skips per hour. Prof. Rubinfeld's analysis effectively assumed an average of *18* skips per hour

on an ad-free subscription service offering unlimited skips. To suggest that this is anything other than a conservative assumption strains credulity.

4. Prof. Rubinfeld Properly Adjusted Interactive Benchmark To Account For Value Of Interactivity

a. Services' Critiques Of Subscription Price Ratio Show That Prof. Rubinfeld's Calculation Of Interactivity Adjustment Was Conservative

449. iHeart's final attempt to substantiate its accusation that Prof. Rubinfeld's data was "unreliable" also falls flat. Along with the other Services, iHeart claims that the subscription price ratio Prof. Rubinfeld used as a basis for his interactivity adjustment was "the result of a flawed data set." IHM PFOF ¶ 315; NAB PFOF ¶¶ 371-72; PAN FOF ¶ 264.

450. The Services suggest that the ratio undervalued interactivity because Prof. Rubinfeld included three radio services on the "non-interactive" side of his subscription price ratio that are not strictly DMCA-compliant: Rhapsody unRadio, Nokia MixRadio, and Slacker RadioPlus.

451. First, on a conceptual level, this quibble does little to undermine the purpose of Prof. Rubinfeld's exercise—isolating the value of on-demand functionality—because none of these three services offer full on-demand functionality. Hr'g Ex. IHM 3476 [redacted].

452. Second, as a practical matter, the Services' argument does not get them anywhere. Excluding these three non-DMCA compliant services from the subscription price ratio would result in a *lower* adjustment factor, and a *higher* adjusted per-play rate for statutory services. *See* Hr'g Ex. SX-45. Prof. Rubinfeld calculated an average subscription price of $4.84 - $5.27 for

non-interactive services. *Id.* Without the $3.99 price for MixRadio Plus, the $3.99 price for Slacker Radio Plus, and the $4.99 price for Rhapsody unRadio, this average would become $5.24 - $5.99, which would yield an interactivity adjustment between 1.64 and 1.88—far less than the 2.0 adjustment applied by Prof. Rubinfeld. *Id.* And if these services were instead included on the interactive side of the ledger, the interactivity adjustment would become even smaller (between 1.5 and 1.72). This reduced adjustment factor would yield substantially higher proposed rates for statutory services.

453. In the end, the Services' critiques only further underscore that Prof. Rubinfeld's 2.0 adjustment factor is extremely conservative. And the "error" they purported to identify is little more than yet another example of the convergence between statutory and non-statutory services in the market.

b. Services' Alternative, "Corrected" Interactivity Adjustments Do Not Isolate The Value Of Interactivity

454. The Services also try to undermine Prof. Rubinfeld's interactivity adjustment calculation by offering alternative adjustment ratios of their own. Each of their so-called "interactivity adjustments" fails to accomplish what an interactivity adjustment is designed to do: identify and isolate the value of interactivity. They therefore in no way undermine the reliability of Prof. Rubinfeld's retail price approach.

455. As SoundExchange has already demonstrated in its Proposed Findings of Fact and in Section III.B.5.e, *supra*, a comparison of interactive and non-interactive subscription prices is the most accurate and reliable way to isolate the value of interactivity. SX PFOF ¶¶ 379, 400-401. A comparison of subscription prices cleanly and clearly evinces the value of interactivity because any functionality from which consumers derive value will command a premium in the marketplace and be directly measurable in the prices charged to consumers. *Id.*

456. The Services' methods of adjusting for interactivity, on the other hand, are inaccurate and improper—they distort and obfuscate the value of interactivity.

457. First, both NAB and iHeart offer flawed revenue-based adjustments. IHM PFOF ¶ 325; NAB PFOF ¶¶ 386-369. As shown in *supra* Section III.B.5.e and SX PFOF ¶ 401, advertising revenue is a misleading basis for comparison because ad revenue is dictated by services' short-term business strategies, not by the value of interactivity. A comparison of services' *total* revenues imparts even less information about the value of interactivity. Rather than isolate the value of interactivity, an apples-to-oranges comparison of advertising revenue and subscription revenue amounts to a relative valuation of the services' business models. iHeart's focus on revenue per performance, as opposed to revenue per user, likewise introduces strategic business decisions into the ratio (e.g. with respect to the number of performances per hour and the service's monetization strategy). The revenue ratios calculated by Profs. Lichtman and Katz mask rather than measure the value of interactivity.

458. NAB's fatally flawed profitability-based adjustment fails to capture the value of interactivity for much the same reasons. *See supra* Section III.B.5.e; SX PFOF ¶¶ 402-403. Setting a rate based on services' profits would nonsensically reward those services that have deferred short-term profits to maximize growth—or those that are simply unsuccessful at controlling costs—with lower royalties. *Id.* Moreover, introducing such incentives would distort the market. *Id.* In addition to suffering from the fundamental conceptual infirmity of failing to isolate the value of interactivity, Prof. Katz's profits analysis depends on arbitrary and unjustified assumptions about the services' non-licensing costs. SX PFOF ¶¶ 402-403. As a result, Prof. Katz's speculative and results-driven analysis distorts the value of interactivity beyond all reasonable measure. *Id.*

459. Prof. Katz's unreasonable profits-based interactivity adjustment is the last—and largest—step in what it purports to be a "corrected" interactive benchmark. NAB PFOF ¶¶ 433-439. But as set forth *supra*, each step in NAB's purported "corrections" to Prof. Rubinfeld's interactive benchmark are premised on fundamental conceptual and analytical errors. Because NAB's deeply flawed adjustments introduce—rather than eliminate—errors, NAB's "corrected" interactive benchmark is entirely uninformative and cannot be relied upon.

460. iHeart proffers one additional alternative ratio that is an unreasonable basis by which to adjust the interactive benchmark: a ratio of the musical works royalties paid by interactive and non-interactive services. IHM PFOF ¶ 327. It is well-established that reference to musical works is inappropriate in the context of this proceeding. "Musical works and sound recording do not compete in the same market, and they have distinct cost and demand characteristics." Report of the Copyright Arbitration Panel, *In re Rate Setting for Digital Performance Right in Sound Recordings and Ephemeral Recordings*, No. 2000-9, CARP DTRA 1 & 2, at 41 (U.S. Copyright Office Feb. 20, 2002) (hereinafter "*CARP Web I Report*"); *accord Web II Final Order*, 72 Fed. Reg. at 24098 ("[T]he musical works benchmark . . . is based on a very different marketplace characterized by different sellers who are selling different rights."); *SDARS I*, 73 Fed. Reg. at 4089; *SDARS II*, 78 Fed. Reg. at 23058. A musical works analysis therefore "by necessity engrafts concepts and presumptions from one marketplace onto another." *CARP Web I Report* at 41.

461. iHeart offers only the bare assertion that, despite the failings of the musical works benchmark, it is "instructive to examine the ratio of rates that interactive and noninteractive services pay for [musical works] rights." IHM PFOF ¶ 327. But any reliance on the entirely distinct musical works market necessarily depends upon a series of assumptions. *CARP Web I*

Report at 39-40. Adding an additional assumption—that there would be an equivalency in the musical works and sound recording cost ratios—on top of these other assumptions in no way saves the analysis. It only introduces more "uncertainty and inexactitude." *Id.* at 39. iHeart's musical works ratio fails to impart any reliable information about the value of interactivity in the sound recording licensing market.

5. Market Evidence And Convergence Support Modest Annual Rate Increases Over The Next Term

462. NAB's and Sirius XM's critiques of the modest annual increases in Prof. Rubinfeld's rate proposal are unfounded. NAB PFOF ¶¶ 541-550; SXM PFOF ¶¶ 69-72. Both rely on misrepresentations of the evidence.

463. Their suggestion that the escalating rates in the [redacted] are an aberration and that "there is simply nothing in the record that would support annual increases in the webcasting rate" appears to be premised on a willful ignorance of the evidence that is in the record. SXM PFOF ¶¶ 70-71; NAB PFOF ¶¶ 541-544. The evidence unambiguously shows that Sirius XM and NAB are flat-out wrong. The modestly escalating rates in SoundExchange's rate proposal are consistent with virtually *every* voluntarily negotiated agreement involving a non-interactive service. *See, e.g.*, Hr'g Ex. SX-33 at 15 [redacted] Hr'g Ex. IHM 3343 at 4 [redacted]; Hr'g Ex. IHM 3345 at 4 [redacted]; Hr'g Ex. IHM 3347 at 6 [redacted]; Hr'g Ex. SX-2071 at 2 [redacted]; Hr'g Ex. SX-2070 at 1-2 [redacted]; Hr'g Ex. PAN 5014 at 5, § 3(a)(ii) [redacted]; Hr'g Ex. SX-121 at 8 (NAB WSA Agreement); Hr'g Ex. SX-124 at 2 (Sirius XM WSA Agreement); Hr'g Ex. SX-80 [redacted]

[redacted]

464. NAB and Sirius XM also both suggest that rate increases are inappropriate because the effective rates for interactive service agreements have been declining. NAB PFOF ¶ 543; SXM PFOF ¶ 71. This argument fails to appreciate that the slight decline in rates for directly licensed services is a function of the convergence in the market. Hr'g Ex. SX-17 ¶ 140. As shown in *supra* Section II.B.2, as lean-back offerings have become increasingly important across the streaming landscape, record companies have had to depress their streaming rates to enable their directly licensed partners to compete with free statutory services. At the same time, statutory services have been [redacted]. SX PFOF ¶¶ 271-289. A modest increase in rates for statutory services is consistent with these services' [redacted] Hr'g Ex. SX-269 at 183. In short, it is important that the statutory rates reflect the convergence in the market by steadily growing "closer to the market rate for streaming services generally"; otherwise, directly licensed services' "rates will likely continue to fall to bring about parity in the market." Hr'g Ex. SX-10 ¶ 18 (Harrison Corr. WDT).

465. Prof. Rubinfeld's proposed $0.0008 annual escalation is also conservative when considered in the context of a five-year license in a rapidly changing streaming market with involuntary licensors. SX PFOF ¶ 398. In their direct license negotiations, record labels endeavor to [redacted] Hr'g Tr. 1028:23-1029:4 (Apr. 30, 2015) (Harrison). As Mr. Harrison explained, Universal [redacted]

[redacted] Hr'g Tr. 1028:15-20 (Apr. 30, 2015) (Harrison). Because the statutory license compels a far longer term than would prevail in the market, modest annual rate increases are important to compensate sellers for the risk mitigation they cannot achieve by negotiating a shorter term, particularly given the inherent asymmetry created by the statutory license. SX PFOF ¶ 398; Hr'g Ex. SX-17 ¶¶ 100, 143 (Rubinfeld Corr. WDT). If the rates set today do not resemble the willing buyer willing seller rates that would be negotiated four years from now, statutory licensors will be left unable to renegotiate for rates that compensate them for the fair market value of their works. Hr'g Ex. SX-17 ¶ 143 (Rubinfeld Corr. WDT); Hr'g Ex. SX-21 ¶ 39 (Wheeler WDT) ("Given what I have said above about the rapid shift in the industry, it is quite important that the statutory webcasting rate continue to escalate over time, particularly because unlike direct negotiations, I have no ability to revisit the situation in a year or two if the market shifts outside our expectations."). Prof. Rubinfeld's rate proposal appropriately—yet conservatively—protects against this risk.

6. iHeart's Critiques Of Prof. Rubinfeld's Proposed Percentage-Of-Revenue Rate Are Misplaced

466. Finally, iHeart's perfunctory critiques of Prof. Rubinfeld's proposed percentage-of-revenue calculation do not withstand scrutiny. IHM PFOF ¶¶ 328-333. Marketplace evidence—[redacted]—corroborates Prof. Rubinfeld's proposal.

467. iHeart's accusation that Prof. Rubinfeld's percentage of revenue rate is "flatly contradicted by market evidence" rests on a fundamentally false premise: that Services' direct agreements with a handful of indies are somehow more probative of market rates than revenue shares negotiated by the majors with custom radio services [redacted] and dozens of directly licensed services that offer a variety of lean-forward and lean-back products. SX PFOF ¶¶ 326-425-430. An unrepresentative, biased sample of 28 agreements says far less about what

the hypothetical market would bear than Prof. Rubinfeld's comprehensive survey of the thick market of directly licensed agreements. *Id.*

468. iHeart's attempt [redacted] only highlights the selective, unreliable nature of its analysis. IHM PFOF ¶¶ 331-332. In any event, it cannot run away [redacted] *See supra* Section III.B.5.d.

469. iHeart's claim that there "is no apparent economic justification" for applying the same percentage of revenue to interactive and non-interactive services similarly ignores the evidence in the record. IHM PFOF ¶ 330. Adjusting the revenue share for interactivity would be improper because any revenue a service derives from its exploitation of sound recordings already accounts for any differential in the value of the rights. *See supra* Section III.B.5.d.; SX PFOF ¶¶ 440-441; Hr'g Tr. 1814:8-13 (May 5, 2015) (Rubinfeld).

470. For this reason, in direct licenses with [redacted] Hr'g Tr. 1013:18-1014:14, 1181:1-16 (Apr. 30, 2015) (Harrison) [redacted].

471. Mr. Harrison explained why Universal [redacted]:

[redacted]

[redacted]

Hr'g Tr. 1191:16-1192:8 (Apr. 30, 2015) (Harrison).

472. iHeart, by contrast, identifies no market evidence that applies a two-factor adjustment to a revenue share to account for the value of interactivity. SX PFOF ¶ 430. Imposing a downward adjustment on the percentage-of-revenue rate that prevails in the market would therefore not only unjustifiably twice-account for the value of interactivity—it would also be inconsistent with the WBWS standard.

F. Apple & III.E Services Support SoundExchange's Rate Proposal

1. Apple's Agreements With Warner and Sony For iTunes Radio Support SoundExchange's Rate Proposal

473. Apple's agreements with Warner and Sony for the iTunes Radio service, a non-interactive radio service that is nearly if not entirely identical in functionality to Pandora and iHeart's services, when properly analyzed – from either a performance or projections-based approach – support SoundExchange's rate proposal.

474. The Services levy a number of critiques on the Apple agreements – none of which is prevailing.

a. Apple's Service Is A Non-Interactive Benchmark

475. The Services, and iHeart in particular, speculate that the Apple agreements with Warner and Sony are not proper benchmarks because the iTunes Radio service may have some extra functionality beyond the limits of the DMCA. *See, e.g.,* IHM PFOF ¶¶ 352-54. This claim is without any basis.

476. The Services do not clearly explain precisely what functionality on the iTunes Radio service exceeds the DMCA's requirements and why. And in fact, Warner's and Sony's

agreements with Apple describe iTunes Radio [redacted] *See* Hr'g Exs. SX-2070 at 19; SX-2071 at 13. Prof. Shapiro also treats iTunes Radio as a DMCA-compliant service in his analysis. *See* Hr'g Tr. 4909:7-12 (May 20, 2015) (Shapiro) ("I'm treating the iTunes Radio service as statutorily compliant, as best I understand it.").

477. The Services reference "caching" as functionality beyond the DMCA, but as the agreements make clear, [redacted] Hr'g Ex. SX-2070 at 2 ¶ (f); *see also* SX-2071 at 2 ¶ (f). In other words, the [redacted]. The Services also have raised questions regarding the iTunes Radio service [redacted]. As the agreements make clear, however, iTunes Radio [redacted] Hr'g Ex. SX-2070 at 19 ¶ 6; *see also* Hr'g Ex. SX-2071 at 13 ¶ 6(i). Thus, iTunes Radio provides [redacted] played.

478. In sum, the Services have failed to identify any specific functionality of the Apple iTunes Radio agreements which is beyond the functionality authorized by the statute.

479. Moreover, the Services do not dispute that Apple contains the same characteristics of a non-interactive service which the Services claim makes those agreements superior to the interactive service agreements, and most notably, the ability to steer. Like Pandora or iHeartRadio, iTunes Radio is a non-interactive radio service, and has the equal ability to steer listeners to music offered by different labels, including independents – to the extent such ability exists for *any* non-interactive service, which SoundExchange disputes. Hr'g Ex. SX-128 ¶ 7

(Rubinfeld Corr. WRT App. 2). Indeed, Prof. Shapiro stated in his written direct testimony, before the Apple agreements became part of this proceeding, that the mere *capability* of steering is sufficient to create a benchmark created by effective or workable competition. *See* Hr'g Ex. PAN 5022 at 9 (Shapiro WDT) (the "ability or inability of a webcaster to steer listeners toward or away from the music of a given record company is fundamental to the licensing negotiations that would take place in the absence of a compulsory license" and the "net result in a workably competitive market may well be relatively little actual steering, yet lower prices to aggregators with the capability to steer.").

480. Moreover, it is difficult to envision a more powerful company sitting on the other side of the negotiating table than Apple, one of the most powerful companies in the world. Hr'g Ex. SX-128 ¶ 7 (Rubinfeld Corr. WRT App. 2). Given Apple's history and unique position in the digital music marketplace, Apple would have possessed significant bargaining power in its negotiations with the record labels. *Id.*

b. Apple And The Labels Agreed To The Risk That The Effective Per-Play Rate Could Be Higher, Or Lower, Than The Existing Statutory Rate

481. The Services contend that Prof. Rubinfeld's calculated effective per-play rates for the Apple Warner and Sony agreements are improper because they exceed the existing statutory rate. *See* Pandora PFOF ¶¶ 340-44; NAB PFOF ¶¶ 443-450.

482. But as explained in SoundExchange's Proposed Findings of Fact (SX PFOF ¶¶ 985-87), wherever there is a [redacted], there will be uncertainty and risk on both sides as to what the ultimate effective per-play rate will be. In the specific context of the Apple iTunes agreements, both sides sophisticated parties, assumed the risk that the ultimate effective per-play rate could be higher, or lower, including higher or lower than the existing statutory rates. *See id.* Thus, the Services'

argument that Apple would not rationally agree to rates higher than the existing statutory rate is a red herring. By agreeing to an [ ], Apple in fact did agree to the risk that the effective per-play rates could exceed the statutory license.

483. And indeed, [ ], and the uncertainty and risk that can accompany them based on performance projections, can play a central role in negotiations where the parties are unable to agree on other forms of consideration, such as, for example, increasing a per-play rate. *See infra*, Section V.B.1; *see also, e.g.,* Hr'g Tr. 3037:9-14 (May 11, 2015) (Katz) [ ]).

484. Focusing on performance data, as opposed to the parties' internal projections, corrects for that uncertainty and risk and provides an objective value to performances made under the terms of the agreement. This is confirmed by the "Book of Wisdom" case law discussed in SoundExchange's Proposed Conclusions of Law, in which the Supreme Court has emphasized that "[e]xperience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect." *Sinclair Ref. Co. v. Jenkins Petroleum Process Co.*, 289 U.S. 689, 698 (1933).

485. It is particularly valuable where, as here, the parties may have different projections based on varying assumptions. At a minimum, the calculated effective rates here counsel in favor of adopting a rate at the high end of the parties' projections.

c. The Services Ignore The Evidence Demonstrating That The[ ]

486. The Services attempt to create confusion as to [ ] *See* Pandora PFOF ¶¶ 345-348; NAB ¶¶ 463-478;

IHM ¶¶ 376-384. These attempts fail. The Services ignore the plain language of the agreements and the undisputed evidence plainly establishing [redacted] *See* SX PFOF 955-974.

487. First, the [redacted]. *See* Hr'g Exs. SX-2070 at § 5(a) (Warner, under [redacted] section); SX-2071 at § 5(c) (Sony, under [redacted] section). Given that the language of the agreements is plain and undisputed, under settled law it would be improper for the Judges to ignore such language, and examine the extrinsic evidence the Services proffer and engage in the speculative "what-ifs" they urge. *See S. Cal. Edison Co. v. F.E.R.C.*, 502 F.3d 176, 181 (D.C. Cir. 2007) ("The Commission may not ignore the plain language of a contract but instead must 'give effect to the unambiguously expressed intent of the parties.'").

488. Nor do the amendments to the Match/Cloud service agreements conflict with the plain language of the iTunes Radio agreements. As noted, when Sony and Warner entered into the iTunes Radio agreements, [redacted].

489. Thus, the [redacted]

[redacted] Hr'g Ex. SX-2073 (emphasis added).

490. Similarly, [redacted] Hr'g Ex. SX-2072. Apple was required to [redacted] *Id.*

491. Nothing in either of these [redacted]. Thus, the amendments to the [redacted] agreements are clear on their face, and do not affect Prof. Rubinfeld's analysis of the Apple agreements.

492. Further, although examining the extrinsic evidence is unnecessary and improper here given the unambiguous language of the agreements, such evidence at any rate clearly supports the view that the [redacted] are allocated solely to the iTunes Radio service.

493. In fact, all of the parties' pre-execution documents treat the [redacted] as applicable solely to the iTunes Radio service. Apple's pre-execution internal overview of the iTunes Radio agreements – [redacted] Hr'g Ex. NAB 4201 at 12-13 [redacted]); Hr'g Tr. 4972:2-8 (May 20, 2015) (Shapiro) [redacted]

494. Second, both Sony and Warner in their internal projection documents relied upon by the Services [redacted].

495. In the Sony document, Sony expressly [redacted]. Hr'g Ex. SX-2145 at 4; *see also* Hr'g Tr. 4993:15-21 (May 20, 2015) (Shapiro) [redacted]

[redacted]

[redacted]]).

496. Similarly, Warner in an [redacted]

[redacted]]. Hr'g Ex. IHM 3549; *see also* Hr'g Tr. 3181:9-15 (May 12, 2015) (Katz) [redacted]

497. Moreover, the parties' ongoing performance under the Apple Sony and Warner agreement confirms [redacted]]. As discussed, iTunes Radio offers a subscription, ad-free service to Match subscribers as part of their annual $24.99 subscription fee. *See* Hr'g Ex. SX-1652 at 10. Match was a pre-existing cloud locker service at the time of launch of the iTunes Radio service. *See, e.g.*, Hr'g Ex. SX-2070 § 1(q) [redacted]

498. Under the terms [redacted]]. *See, e.g.*, Hr'g Ex. SX-2181 at 7, § 3.b ([redacted]); Hr'g Ex. SX-2182 at 8, § 2.j ([redacted]); Hr'g Tr. 3192:16-19 (May 12, 2015) (Katz) [redacted]

[redacted]]).

499. As Prof. Katz acknowledged, if the [ ]. *Id.* at 3195:17-23]).

500. The Services ignore that these payments for [ ] Hr'g Ex. SX-2071 at 18 (emphasis added). If the [ ].

501. Similarly, the Warner agreement states that] Hr'g Ex. SX-2070 at § 1.x (emphasis added); *see also* Hr'g Ex. SX-2171 at § 1.y ([ ]

502. Additionally, the Services' argument that the [ ]. Prof. Shapiro estimates the number of Match subscriber performances to be 5% of all iTunes Radio performances. Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT). Under that assumption, [ ]. *See* Hr'g Ex. SX-128 (Rubinfeld Corr. WRT App. 2) (Sony – [ ].) This demonstrates that the more sensible, rational interpretation of the agreements from an economic perspective [ ].

503. Furthermore, [ ] is also consistent with the parties' post-deal analyses. In response to the Services' subpoena requesting documents or analyses showing the "effective per-performance royalty from Apple to the label for performances through the Service," Apple produced a spreadsheet showing rates [ ] for Warner and Sony, generally ranging between [ ]. Hr'g Ex. SX-2064A.

504. Similarly, Warner in a document entitled [ ], showed an effective per-play rate for Apple of [ ] Hr'g Ex. SX-296 at 4.

505. Finally, in making their argument, the Services rely heavily on the Universal-Apple agreement and related extrinsic evidence, which treated the [ ], to support their interpretation of the Warner and Sony agreements. At the outset, it is worth emphasizing that notwithstanding how [ ], Apple in its own internal overview of the iTunes Radio agreements– [ ] Hr'g Ex. NAB 4201 at 12-13]).

506. But moreover, the Universal-Apple agreement is a different agreement, negotiated between different parties, and is of limited relevance in construing the agreements between Apple and Sony and Warner. *Cf. Hughes v. State Farm Fire & Cas. Co.*, No. Civ.A. 3:2005-357, 2007 WL 2874849, at *4 (W.D. Pa. Sept. 27, 2007) ("Decisions interpreting materially different contractural language, even under similar sets of facts, are of little value in determining the meaning of the particular . . . contract at issue in a given case."). Thus, the Judges should accord it very little weight in construing the Apple Sony and Warner agreements.

507. In sum, the Services' theory that the [ ]

d. SoundExchange's Performance-Based Calculations For The Apple Agreements Are Proper, And Even Taking Into Account The Services' Criticisms, Yield Rates Supportive Of SoundExchange's Rate Proposal

508. The Services lob several attacks on Prof. Rubinfeld's performance-based calculations with respect to the Apple iTunes Radio agreements for Sony and Warner. Each of those arguments are without merit.

509. Prof. Rubinfeld adjusted his calculated rates for the Apple Warner and Sony agreements to account for differences in [ ]. The Apple iTunes Radio performance data [ ]. *See* Hr'g Ex. SX-128 ¶¶ 28, 40 & ns.22, 31 (Rubinfeld Corr. WRT App. 2). As noted, *supra*, Section III.E.3, Prof. Rubinfeld estimated [ ]. *See id.*

510. First, the Services attack Prof. Rubinfeld's royalty-bearing plays adjustment as failing to take into account certain non-compensable plays, such as royalty-bearing plays and skips. NAB PFOF ¶¶ 479-486; IHM PFOF ¶¶ 368-371. They argue that Prof. Rubinfeld's [ ]. *See id.*

511. As noted in SoundExchange's Proposed Findings of Fact (SX PFOF ¶¶ 995-999), this is an improper comparison for several reasons. First, [ ] Hr'g Ex. NAB 4201 at 3. Given that such [ ].

512. As Prof. Shapiro states in his testimony, [redacted] Hr'g Ex. PAN 5365 at 14 n.55 (Shapiro Supp. WRT). For the same reason that there is no need to adjust an effective per-play rate based on incremental download revenue that is beneficial to both Apple and the labels, there is no need to adjust an effective per-play rate based on [redacted].

513. Second, Prof. Katz's 1.8 adjustment assumes that Apple [redacted].

514. Consistent with Prof. Rubinfeld's [redacted] Hr'g Ex. PAN 5022 at D-7 & n.10 (Shapiro WDT).

515. Finally, even if one were to accept Prof. Katz's 1.8 adjustment, [redacted]. Hr'g Ex. NAB 4015 at 142 & Table 11.

516. The Services also attack Prof. Rubinfeld's calculations of the Apple Warner and Sony rates for only examining 13 months of performance data (out of a 2-year agreement), suggesting that his rates would be different if he examined subsequent months of performance data under the agreements. *See* NAB PFOF ¶ 450; IHM PFOF ¶ 367.

517. The Services ignore, however, that Apple's own calculations of the effective per-play rates of the Sony and Warner agreements, from December 2013 through March 2015, generally range between [redacted], with only the last 3 months showing a slight decrease below [redacted]. Hr'g Ex. SX-2064A. Thus, Apple's own calculations, which extend to only a few months ago, show rates in line with (if not greater than) Prof. Rubinfeld's calculations.

e. The Services' Expectations Analysis Is Both Methodologically Flawed And Incorrect

518. Attacking SoundExchange's analysis of the iTunes Radio agreements based on performance data, the Services principally propose an expectations-based analysis. Pandora PFOF ¶¶ 350-360; IHM PFOF ¶¶ 363-367, 392-97. The Services' approach is both methodologically flawed, and incorrect.

519. First, the Services' complete refusal to consider performance-based data *at all* is legally improper under the "Book of Wisdom" case law, as discussed in SoundExchange's Proposed Conclusions of Law, Section IV.A, and Reply Conclusions of Law, Section III.B. SoundExchange in turn has presented a more fulsome and comprehensive analysis by analyzing both projections data and performance data.

520. And even with respect to the projections data, the Services largely ignore Warner and Sony's internal expectations data, which is far closer to SoundExchange's rate proposal than the Services', focusing exclusively on Apple's projections. As noted, wherever there is a [redacted]

[redacted], there will be uncertainty and risk on both sides as to what the ultimate effective per-play rate will be. Here, Apple, Sony, and Warner, all sophisticated parties, assumed the risk that the ultimate effective per-play rate could be higher, or lower, including higher or lower than the existing statutory rates. At a minimum, the calculated effective rates here counsel in favor of adopting a rate at the high end of the parties' projections – here, Sony – because they reveal which parties' expectations were in fact more accurate.

521. As noted in SoundExchange's Proposed Findings of Fact, Sony projected an [redacted]. *See* Hr'g Ex. SX-2145 at 4, 7 (under column [redacted]); Hr'g Ex. PAN 5365 at 15 (Shapiro Supp. WRT) (noting that Sony [redacted]); Hr'g Tr. 3161:13-3162:10 (May 12, 2015) (Katz) ([redacted]).

522. Warner's internal projection models [redacted]. *See* Hr'g Ex. IHM 3549 at 1; *see also* Hr'g Ex. NAB 4015 ¶ 226 (Prof. Katz relying on these internal projections). Conservatively [redacted]. *See* Hr'g Ex. IHM 3549 at 1. As Prof. Katz testifies, [redacted]

[redacted]. *See* Hr'g Ex. NAB 4015 ¶ 226; Hr'g Tr. 3200:20-25 (May 12, 2015) (Katz) ([redacted]).

523. Notwithstanding the fact that Profs. Shapiro and Katz both relied upon and confirmed these internal projections in their own testimony, iHeart asks the Judges to ignore them. *See* IHM PFOF at 178 n.21. iHeart's argument should be rejected. These expectations analyses from Sony and Warner were relied upon and confirmed by both Pandora's and NAB's experts, and iHeart has raised no reason why the Judges should not rely upon them.

524. The Services also rely upon Prof. Shapiro's mid-point analysis of the parties' projections. *See, e.g.,* IHM PFOF ¶¶ 392-397. As demonstrated in SoundExchange's Proposed Findings of Fact, that analysis is flawed for several reasons. First, as Prof. Shapiro acknowledged, simply taking parties' projected effective per-play rates does not tell you what their ultimate willingness to pay or willingness to sell values are and the range between them, i.e., the parties' bottom lines. *See* Hr'g Tr. 5036:6-24 (May 20, 2015) (Shapiro) [redacted]).

525. Second, notwithstanding that Apple provided [redacted].] In so doing, Prof. Shapiro assumes [redacted] (Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT)), which is highly questionable, if not erroneous. [redacted]

[redacted]. *See* Hr'g Tr. 5025:1-4 (May 20, 2015) (Shapiro). In addition, Prof. Shapiro [redacted] (Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT), but for the reasons discussed above, under Prof. Shapiro's own reasoning [redacted].

526. Finally Prof. Shapiro treats all Match subscriber performances as [redacted]. Hr'g Ex. PAN 5365 at 13 (Shapiro Supp. WRT). But as discussed above, [redacted].

527. Correcting for these three errors, and using a [redacted]. *See* Hr'g Tr. 5032:19-23 (May 20, 2015) (Shapiro).

528. If one were to take the simple average of Sony, Warner, and these corrected estimated projections for Apple for the first year of the agreement, that would yield a rate of [redacted]. But as discussed above, it makes more sense to place greater weight on the parties' higher projections given what the actual performance data shows.

529. Finally, NAB presents an alternative Apple analysis based on the Apple-Universal agreement and the Apple-independent agreement. NAB PFOF ¶¶ 487-494. NAB's alternative analysis is flawed for several reasons.

530. First, it its improper to wholly ignore the Apple Warner and Sony agreements, given that they constitute a substantial number of performances on the iTunes Radio Service – Sony has had approximately [redacted]. *See* Hr'g Ex. SX-128 (Rubinfeld Corr. WRT App. 2) (Note References B / A).

531. Second, this analysis not only ignores [redacted]). There's [redacted]]. Indeed, that it is precisely what Apple itself did in its own internal calculations. Hr'g Ex. NAB 4201 at 12-13 [redacted]]).

532. And as discussed above, [redacted], which Prof. Shapiro estimates to be approximately 5% of all iTunes Radio performances, results in absurdly high per-play rates for those performances. Thus, for sound economic reasons as well it makes sense to [redacted].

533. With respect to NAB's analysis of the Apple-independent agreement, that agreement is not representative of the broader market, particularly given the three Apple agreements with the major labels. Moreover, in Prof. Rubinfeld's analysis and calculations of the Apple agreements with Warner and Sony, [redacted]

[redacted]]. *See* Hr'g Ex. SX-128 ¶¶ 29, 41 (Rubinfeld Corr. WRT App. 2).

534. Lastly, NAB's compensable plays adjustment, which relies upon Prof. Katz's actual performance data analysis (1.8) (NAB PFOF ¶ 492) is flawed for the reasons discussed, *supra*, Section III.F.1.*d*. NAB also is being inconsistent – they critique Prof. Rubinfeld for doing a performance-based analysis of the Apple Sony and Warner agreements, yet also rely on the performance data in coming up with a compensable plays adjustment.

f. The Services' Arguments Regarding The Influence Of The Statutory Shadow And These Proceedings On The Apple Agreements Are Without Merit

535. The Services – and NAB and iHeart in particular – also critique the Apple Sony and Warner agreements as negotiated in the shadow of the existing statutory rates. NAB PFOF ¶¶ 451-458, IHM PFOF ¶¶ 356-62. Of course, that critique is equally true of the other non-interactive service agreements offered by the Services as benchmarks, such as the Pandora-Merlin agreement and the iHeart-Warner agreement.

536. SoundExchange does not dispute that the Apple Sony and Warner agreements are affected by the shadow, but there is reason to believe they are less affected than the Pandora-Merlin or iHeart-Warner agreements. As noted, the effects of the shadow are somewhat reduced where the parties depart from structure of the statutory license through alternative compensation arrangements, [redacted] as is the case with the Apple Sony and Warner agreements. *See supra* Section III.B.3.

537. The Services also attempt to discount the Apple agreements as being purportedly intended to influence these proceedings. This is contradicted by the agreements themselves and

the parties' conduct and, at any rate, are irrelevant. *See* NAB PFOF ¶¶ 451-458; IHM PFOF ¶¶ 356-62.

538. First, as Prof. Shapiro testified, all parties negotiate non-interactive streaming agreements with an eye towards how they may be used in this proceeding and may influence the ratemaking process. *See* Hr'g Tr. 4760:2-8 (May 19, 2015) (Shapiro) ("it's my understanding and assumption in general that everybody in the industry is looking -- is concerned about impact on precedent, as I said before, because it's likely that deals will -- direct deals will show up here in the next round of the CRB proceedings."). Thus, the Services' speculation that this may also be the case with the iTunes Radio agreements does not diminish the agreements as a benchmark – or at least not any more than the Pandora-Merlin or iHeart-Warner benchmarks would themselves be diminished. Indeed, iHeart's own documents and testimony demonstrate that the [redacted]. *See infra* at Section V.A.1.

539. Furthermore, of all the non-interactive service agreements offered in these proceedings, the Apple agreements with Warner and Sony may be least vulnerable to this concern.

540. Both agreements [redacted]. Hr'g Ex. SX-2070 § 16; *see also* Hr'g Ex. SX-2071 § 15.

541. Contrary to the Services' speculative theory that Apple was trying to help the labels influence this proceeding, Apple did not participate in this proceeding, and it [redacted]. *See, e.g.,*

Hr'g Ex. SX-17 ¶¶ 17, 163 (Rubinfeld Corr. WDT). Apple also vigorously *opposed* the Services' subpoena seeking third-party discovery from Apple.

g. The Services' Claim That Apple Would Agree To Higher Rates Because Of Additional Sources Of Revenue Under The Agreement Ignores That The Labels Would Receive Even Greater Sources Of Revenue, Providing A Stronger Incentive For Them To Agree To Lower Rates

542. The Services argue that the rates in the Apple agreements with Warner and Sony are higher than they otherwise would be because Apple would obtain additional incremental sources of revenue under the agreements. NAB PFOF ¶¶ 459-462; IHM PFOF ¶¶ 385-88. This argument is incorrect because the additional sources of revenue Apple would receive would also flow – in even greater amounts – to the record labels, who would therefore have a corresponding incentive to agree to even *lower* rates than they otherwise might agree to. In the end, these corresponding incentives cancel themselves out.

543. [redacted]

544. [redacted]

[redacted]

545. [redacted]

546. [redacted]

[redacted]

547. As Prof. Katz acknowledged, record labels would consider such [redacted]

548. Prof. Shapiro agrees with this. As he states in his testimony, [redacted] Hr'g Ex. PAN 5365 at 14 n.55 (Shapiro Supp. WRT).

2. The Section III.E Services Offer Fundamentally Similar Offerings Licensed At Royalty Rates That Confirm SoundExchange's Rate Proposal Is Reasonable; None Of The Services' Arguments To The Contrary Undermine This Simple Fact

549. Prof. Rubinfeld analyzed the Section III.E services as evidence directly rebutting the Services' "webcaster" benchmark agreements because these functionally similar services confirm SoundExchange's rate proposal. Each of these offerings provides "radio-like" streaming that is not on-demand. Accordingly, the Services' arguments that interactive benchmarks

purportedly occupy a fundamentally different market due to the presence of on-demand functionality cannot be made against these offerings. This subsection addresses each of the III.E offerings in turn, rebutting the Services' critiques as well the rates that corroborate Prof. Rubinfeld's interactivity adjustment and SoundExchange's rate proposal[25]

550. The Services' headline argument as to why the Judges should ignore the Section III.E corroborative evidence is because these offerings provide certain features (often unknowable to the consumer) that take them outside of the statutory license. IHM PFOF § VII.A (¶¶ 401-16); NAB PFOF. This is unsurprising because they are directly licensed, not statutory services, and therefore need not comply with the statute. It also speaks little to their actual comparability as offerings because each of the Service participants here also has functionality that takes it outside the statutory license in some respects:

- Pandora offers on-demand streaming in the form of Pandora Premieres. Hr'g Ex. PAN 5002 ¶ 30 (Fleming-Wood WDT). Pandora's agreement with Merlin further [redacted]. *See* PAN Ex. 5014 §§ 1(c)(v), 2(c).
- iHeart [redacted]. Hr'g Ex. SX-34 §§ 1, 1(a).
- The NAB Broadcasters each take advantage of directly negotiated waivers to the performance complement as a part of their settlement with SoundExchange. Hr'g Ex. NAB 4001 ¶ 28 (Newberry WDT); Hr'g Ex. NAB 4101 (NAB waiver agreements); Hr'g Tr. 3653:18-3654:1 (May 13, 2015) (Littlejohn) (explaining that performance complement does not apply to simulcasts).

[25] Pandora does not affirmatively provide any findings of fact regarding the Section III.E services. Rather, it attempts to incorporation by reference those arguments made in its renewed motion to exclude Prof. Rubinfeld's testimony on the subject. *See* PAN PFOF ¶ 340 n.49. Such an incorporation by reference is not proper for findings of fact, and SoundExchange opposes it. Because Pandora's arguments are largely duplicative of those made by iHeart and NAB, SoundExchange nonetheless fully addresses them herein.

- TuneIn, an aggregator for simulcast stations, offers functionality that lets the consumer pause, restart, and record tracks. Hr'g Tr. 5850:9-5851:7 (May 26, 2015) (Dimick).

Accordingly, that these services differ in only minor ways from the statutory restrictions makes them *more* similar to the Service participants here, and certainly does not defeat the informative value of the negotiated per-performance rates.

551. Apart from arguing that the Section III.E Services are not sufficiently similar to be rebuttal evidence and corroborative of SoundExchange's benchmark analysis, the Services make three arguments as to why the rates are not informative:

552. *First*, they argue that because the functionality of each of the Section III.E services surpasses that available under the statute, SoundExchange was obligated to adjust the rates downward as it did for the interactive services. *See* IHM PFOF ¶ 399 (chiding SoundExchange for "not even attempt[ing] to adjust the rates. . . to account for this extra-statutory functionality"); NAB PFOF ¶ 516-17 (arguing that Nokia must be adjusted downward). However, that Prof. Rubinfeld did not adjust the rates, does not make them any less useful as unadjusted marketplace agreements evincing the rates and terms (and rights) to which willing buyers and willing sellers *did* in fact agree outside the shadow of the statutory license. Moreover, at least one of the offerings—Beats' The Sentence—requires no interactivity adjustment at all because it has no interactive features and the performance complement waiver requires no substantial adjustment at all. *Compare* NAB Settlement Rates (ranging from $0.0017 to $0.0025 over the 2011-2015 term) with CRB Commercial Webcaster Rates (ranging from $0.0019 to $0.0023 over the 2011-2015 term).

553. *Second*, the Services argue that because the Section III.E offerings (except for Nokia MixRadio) are licensed together with the on-demand functionality and offerings of those services they cannot be "disentangled" from the interactive rates. IHM PFOF ¶ 400; *see also*

NAB PFOF ¶¶ 506-09 . However, these rates are in fact only artificially *lower* than they would otherwise be because they were negotiated as gateways to subscription services, or "funnels," as described by fact witnesses for the record companies. Furthermore, that the rates are tied to interactive services does not mean they are "inextricably bundled" any more than the existence of additional terms and consideration such as [ ] impacts the ability of an expert to analyze the iHeart and Pandora benchmarks. They are simply interrelated terms. The Services give no reason why their argument *against* the rates for Section III.E. services does not apply with equal force to all of the direct licenses. *See* IHM PFOF ¶¶ 417-21.

554. *Third*, iHeart critiques Prof. Rubinfeld for not adjusting for the shadow of the statutory license, but fails to offer any method of doing so. Precisely because these tiers are closer to the statutory services, he looks to them as confirmatory rather than primary benchmarks.

555. The Judges should rely on the stated rates of these agreements for exactly what they are—corroborative marketplace agreements between willing buyers and willing sellers for similar rights to those authorized by § 114 which confirm that the interactive benchmark rates, as adjusted, are reasonable. To the extent that Pandora, iHeartRadio, and other statutory services have an ability to steer due to the very nature of being programmed as opposed to on-demand, these offerings have the same ability. That these agreement *do not* contain steering provisions is evidence that, absent a statutory license, neither would those of non-interactive services. *See infra* Section IV.E.

556. SoundExchange's Proposed Findings of Fact discuss each of the Section III.E services in detail and explain why the functionality is substantially similar to that available under

the statute. *See* SX PFOF § XI.B (¶¶ 1015-33). Notably, while Prof. Rubinfeld and SoundExchange's findings focus on the actual functionality, rates, and terms agreed to in willing buyer-willing seller agreements, the Services' do not examine the agreements at all. *See, e.g.*, Hr'g Tr. 3640:6-9 (May 13, 2015) (Littlejohn) (admitting that his testimony "doesn't say anything about what is contracted between the parties."). In Reply, rather than rehash each argument in full here, what follows will merely highlight the key differences between the Services' and SoundExchange's Findings on this issue, as well as respond to the erroneous and irrelevant arguments made by the Services.

a. Beats' The Sentence

557. ***All parties agree*** that Beats' offers both a subscription that includes on-demand functionality *and* an offering that is free-to-the-consumer and closely resembles the functionality of statutory services ("The Sentence" or "The Limited Free Services"). *See* NAB PFOF ¶ 498-99; IHM PFOF ¶ 404. In fact, The Sentence is identical to the statutory functionality with a single exception—[ ]. *See, e.g.*, Hr'g Ex. SX-36 at 12]); SX PFOF ¶ 1022; NAB PFOF ¶ 501. To the extent that iHeart continues to muddy the waters by insisting that Mr. Littlejohn's testimony is evidence relevant to The Sentence, Mr. Littlejohn himself admitted that he tested only the "free trial" of the subscription service and "didn't use it beyond the free trial period." Hr'g Tr. 3641:23-25 (May 13, 2015) (Littlejohn). During his cross-examination, Mr. Littlejohn admitted that The Sentence, which was demonstrated in the hearing room, had significant limitations that he did not observe including limited skips, no offline access, no on-demand access, and constant upsell messaging. *Id* at 3648:15-3650:25.

558. Regarding the single aspect of The Sentence that exceeds the statutory requirements as described above, [ ]. The restriction is identical to [ ]. Hr'g Ex. SX-34 §§ 1, 1(a). Such a restriction is also likely unobservable by the consumer [ ].

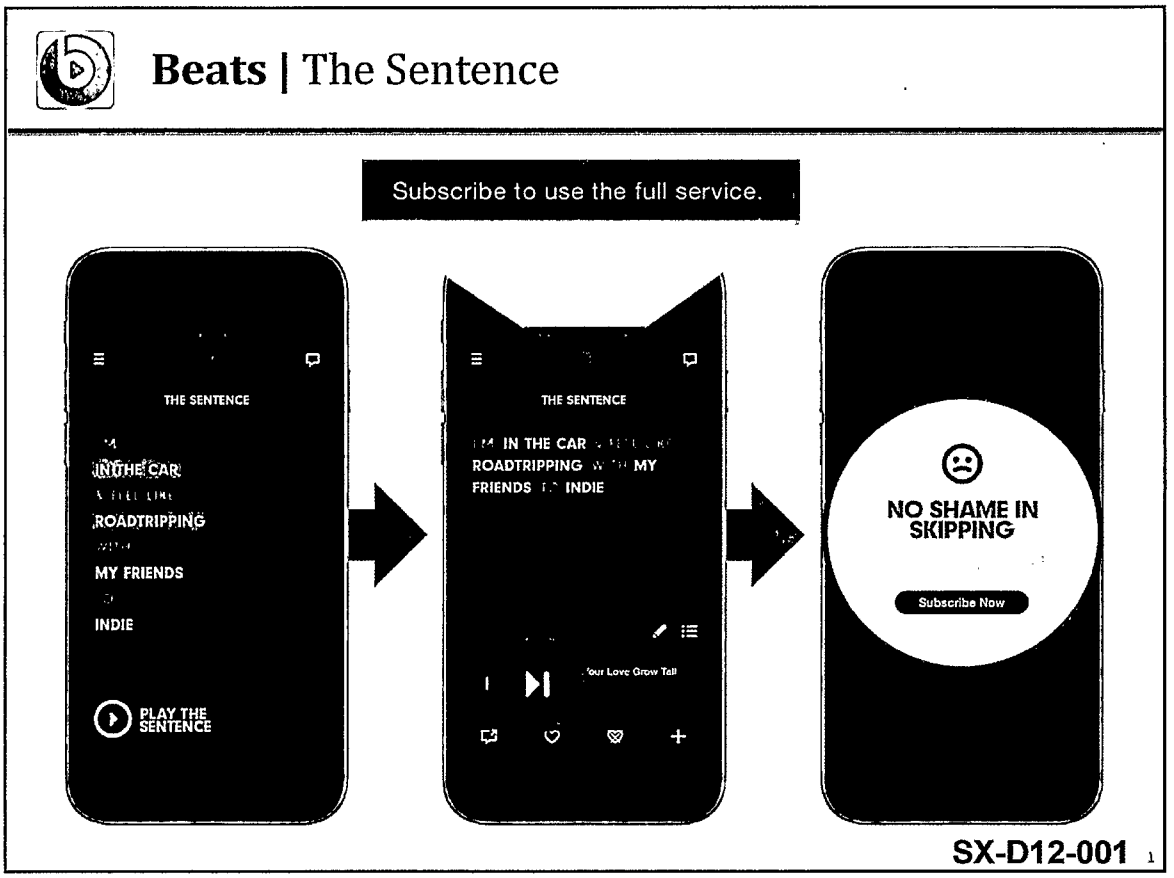
559. ***iHeart and NAB*** argue that Beats' The Sentence was "no longer offered" at the time of the hearing and that, therefore, "no witness was able to testify regarding the functionality of this service as it was actually deployed."[26] IHM PFOF ¶ 405-06; *see also* NAB PFOF ¶ 504. This is simply wrong as a matter of fact and as a characterization of the testimony at the hearing.[27] ***Pandora***, on the other hand, readily admits that Beats' The Sentence is still offered and is not limited to mere partial songs as NAB contends. Hr'g Ex. PAN 5364 ¶ 14 (Fleming-Wood SWRT) ("After the trial period expires, and the on-demand features are no longer available, it appears that users are able to continue using The Sentence portion of the Beats service in some fashion (it is not entirely clear for how long); the goal, however, appears mainly

[26] ***iHeart*** also claims, in a last ditch effort to muddy the waters, that the agreement is not proof of the functionality that was actually deployed. *See* IHM PFOF ¶ 408. This argument is factually wrong because the functionality of Beats does correspond with the agreement, is in tension with iHeart's *opposite* position regarding the Apple iTunes agreements (IHM PFOF ¶¶ 352-55), and is irrelevant because the agreement represents the rates and terms to which the parties agreed.

[27] Of course, even if The Sentence were discontinued (or will stop in the future due to the launch of Apple Music), this is of no consequence. The market is *very* rapidly evolving, and the evolution of Beats after the Apple acquisition does not undermine that it was a willing buyer-willing seller agreement. Further, to the extent that the Services argue the Judges should look to the *performance* of that agreement, it is a concession on their part that SoundExchange's performances analyses of iHeart-Warner, Apple iTunes Radio, and other agreements are valid.

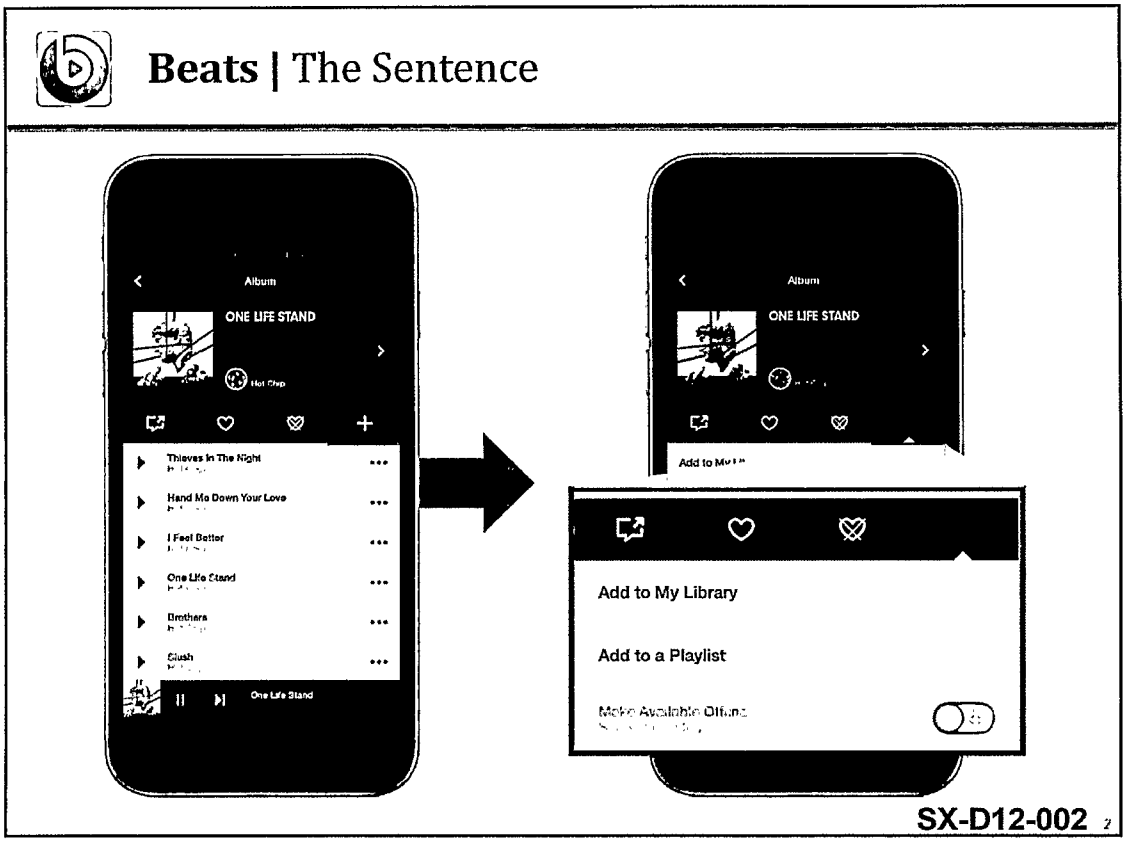
to be ***to try to convert users to paid subscribers of the full Beats service***, not to run a standalone streaming service.") (emphasis added). Likewise, during cross-examination of Mr. Littlejohn, he acknowledged and testified to the features that he observed in Beats' The Sentence offering, which are depicted below (Hr'g Tr. 3648:15-3650:25 (May 13, 2015) (Littlejohn)):

THE SENTENCE DOES NOT PERMIT UNLIMITED SKIPPING



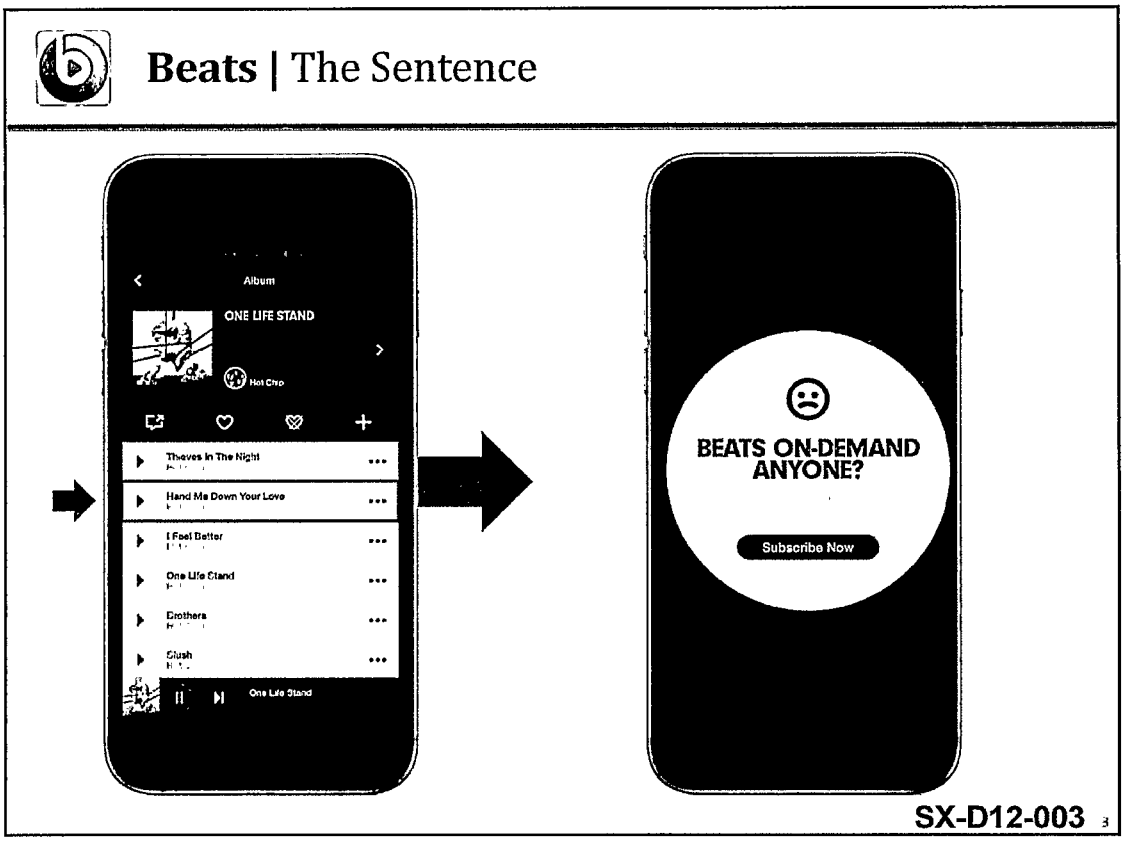
Hr'g Demonstrative SX-D12 at 1.

THE SENTENCE DOES NOT PERMIT OFFLINE LISTENING



Hr'g Demonstrative SX-D12 at 2.

THE SENTENCE DOES NOT PERMIT ON-DEMAND ACCESS



Hr'g Demonstrative SX-D12 at 3.

560. The ***Services*** also argue that because the purpose of the service was to "encourage people to subscribe," these rates are somehow *less* meaningful. *See, e.g.,* NAB PFOF ¶¶ 506-09. To the contrary, incentivizing users to subscribe is *exactly* what each of the record label fact witnesses who address the subject of licensing testified was their goal—promote higher-ARPU services, and encourage people to pay for the music that they consume. *See, e.g.*, Hr'g Ex. SX-27 at 20 (Kooker WRT). Absent a statutory license, this is exactly what the willing sellers would seek to do (and do seek to do) in the market. Accordingly, the rates for these "funnel" tiers of services are extremely relevant to what willing sellers would agree to license for similar functionality in the market were there no statutory license. *See generally* Hr'g Tr. 1045:17-

1049:10 (Apr. 30, 2015) (Harrison) (discussing the [redacted]). A license to a similar service *without* [redacted]—in other words, a standalone ad-supported service without any contractual link encouraging the subscription offering, e.g., Pandora—would be licensed at higher to make up for the lost opportunity to earn more from subscription revenue.

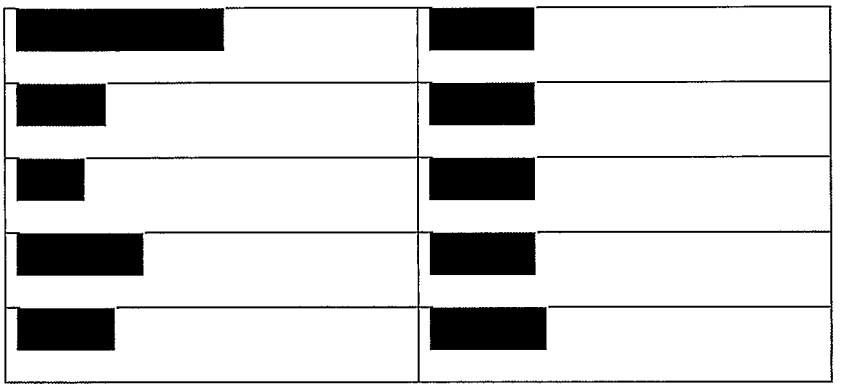
561. Furthermore, directly contrary to Katz's "hypothetical example, showing how record companies and Beats could agree to a higher than stand-alone royalty" (NAB PFOF ¶ 509 (citing Hr'g Ex. NAB 4015 ¶ 245 (Katz AWRT)), this is not what in fact happened. One of iHeart's exhibits shows that [redacted]

Hr'g Ex. IHM 3543 at 4.

562. Finally, the ***Services*** argue that the purportedly [redacted] make the rates and terms to which the parties agreed less meaningful. NAB PFOF ¶ 503, 505; IHM PFOF ¶ 405. Notably, this argument is in tension with the Services' argument that *expectations*, and not performance, are all that is relevant to a benchmark analysis. It is likewise inconsistent with their efforts to trumpet fraction-of-the-market benchmarks: the Pandora-Merlin agreement represents only a fraction of the performances on that service as do the iHeart-Independent agreements. NAB witnesses testified to the small number of listeners who actually stream their simulcasts. In any event, it does not change the usefulness of the offering as rebuttal evidence because Prof. Rubinfeld looks to the stated contractual rates. The

agreement itself reflects certain minimum stated rates that confirm SoundExchange's rate proposal.

563. Beats' The Sentence rates are:



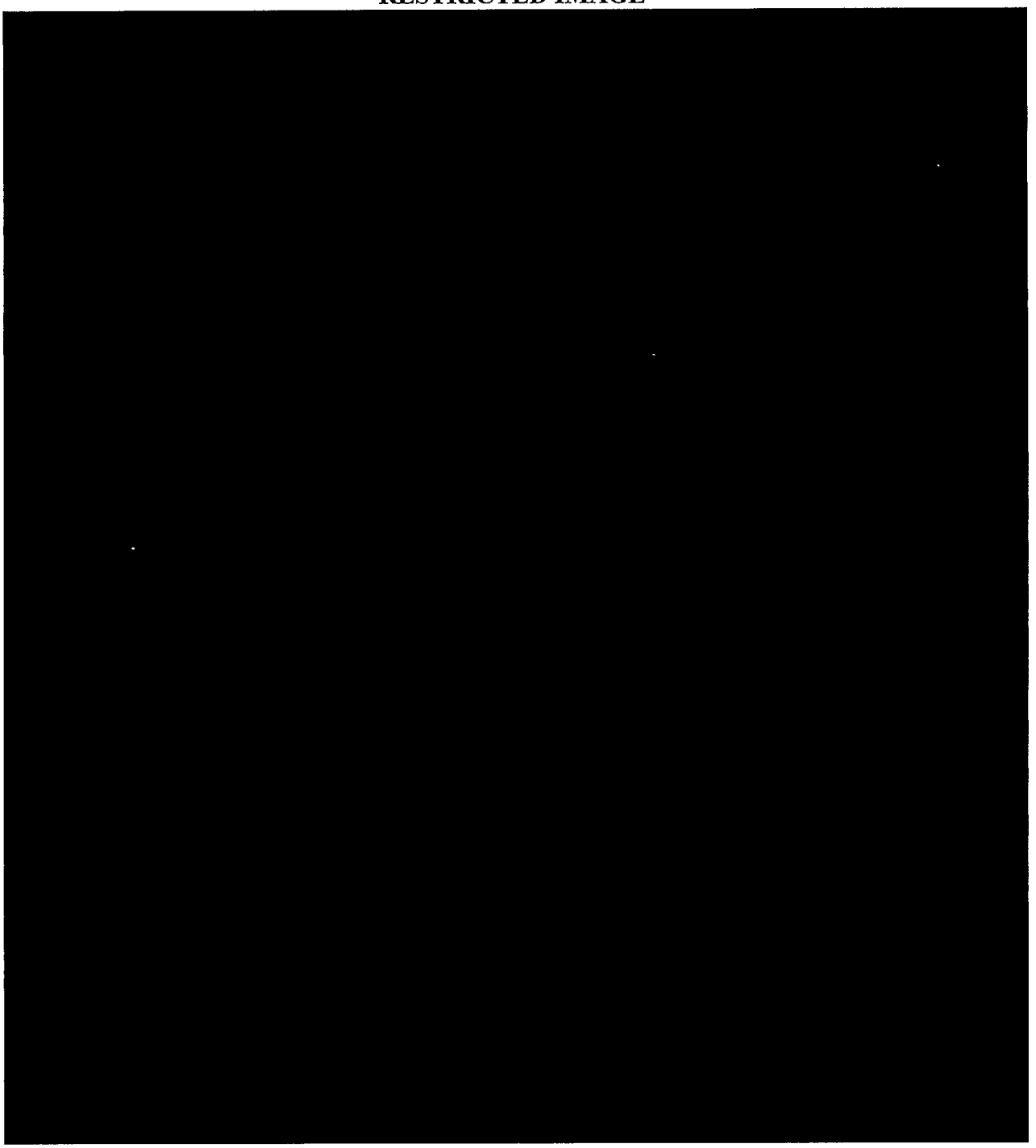
564. The range of rates from [redacted] is consistent with SoundExchange's rate proposal of $0.0025 starting in 2016.

b. Spotify Shuffle

565. ***All parties agree*** that Spotify Shuffle does not have identical functionality to that available under the statutory license. NAB PFOF ¶¶ 532-33; IHM PFOF ¶¶ 409-11. The point of highlighting the Spotify Shuffle rates is that it is an ad-supported service just like Pandora [redacted].

566. The ***Services*** nonetheless maintain that some additional adjustment would be required. iHeart's own documents, however, reveal [redacted]:

RESTRICTED IMAGE



Hr'g Ex. SX-213 (highlights added). This email, written by iHeart lawyer Tres Williams to be sent to Warner, states that iHeart believes that it [redacted]

[redacted]. *Id.* In other words, iHeart believes that a version of Spotify Shuffle would be permissible under the statutory license.

567. The ***Services*** also offer that the rates for the Spotify Shuffle service are "interdependent" and, again, hypothetically, the record companies might seek a higher rate. *See* NAB PFOF ¶ 537; IHM PFOF ¶ 418. Prof. Katz argues that this makes it difficult to interpret the Spotify rates. NAB and iHeart further cite Prof. Katz for his assumptions (not based on admitted evidence nor questioning at the hearing) that these rates were somehow devised for the CRB.[28] There is no evidence in the record proving this fact and even if there were, it does not change the economics of the agreements. One interpretation is abundantly clear: [redacted]. *See* SX PFOF ¶ 1026 (citing agreements).

568. The Spotify Shuffle rates are [redacted]). *See* Hr'g Ex. SX-109 ([redacted]) at AGMT-000103; Hr'g Ex. SX-80 ([redacted]) at SNDEX0055405-23; Hr'g Ex. SX-87 ([redacted]) at SNDEX0056492; Hr'g Ex. SX-100 ([redacted]) at SNDEX0056191.

569. NAB, through Prof. Katz, levies the additional critique that purported "adjusted" effective rates for Spotify's free tier are [redacted]

[28] Notably, this is hearsay admitted for the truth of the matter rather than for the fact that it informed the experts' opinions or another's state of mind. Without the underlying documents admitted as evidence, this is improper.

[redacted]]. This also ignores [redacted]]. Finally, Prof. Katz neglects [redacted]]. *See id.*

570. It is further worth noting that even these stated per-performance rates are [redacted] and are evidence of the pressure that Pandora, subsidized by non-precedential, exceedingly low per performance rates, puts on the record companies to lower rates for their partner services. As Mr. Harrison explained at the hearing—this was a unique circumstance and the impact that had on UMG:

[redacted]

[redacted]

Hr'g Tr. 1047:8-1049:10 (Apr. 30, 2015) (Harrison).

c. Nokia Mix Radio

571. ***All parties agree*** that Nokia MixRadio is a programmed radio service, *not* an on-demand service. Many of the features iHeart describes as "extra-statutory functionality" such as social media integration, "personalized individual radio stations shaped by a user's listening habits," and higher-quality audio are fully available to statutory services. IHM PFOF ¶¶ 413-14. Only the ability to play entire playlists (in random order) offline and unlimited skips (for the subscription service *only*) are beyond the statutory license. *See* NAB PFOF ¶¶ 515-17 (describing only caching as extra-statutory functionality). Accordingly, the Nokia MixRadio non-subscription offering has only a single feature—offline listening—that takes it beyond the statutory functionality.

572. The ***Services*** argue that because Nokia's business model bundles the service with the sale of phones, it "cannot be deciphered without unbundling the bundle." IHM PFOF ¶ 412, 419; *see also* NAB PFOF ¶¶ 519-22 (also arguing that the fact that the Nokia agreement is

[ ] impacts its relevance). This makes no sense. The royalty rates paid by the service are just that—royalties for the sound recordings performed in the United States. These can be analyzed just as every other services' rates are analyzed on a stated rate basis and an average effective rate basis, and that is how Prof. Rubinfeld analyzed them here. Regardless, the stated per-performance rates (which are *not* tied to the sale of phones) provide useful information as to the base rates for a radio-like streaming service, as described below.

573. The [ ] SoundExchange's Rate Proposal. Hr'g Ex. SX-29 ¶¶ 200-01 (Rubinfeld Corr. WRT).

574. Nonetheless the ***NAB*** argues (1) that the stated per-performance rates are an outlier because they are so high for a programmed service, and (2) that Prof. Rubinfeld was wrong to not adjust downward for the extra-statutory functionality. NAB PFOF ¶¶ 516-18. NAB does not affirmatively argue, however, that adjusting for the additional functionality, [ ], would undermine SoundExchange's rate proposal. Indeed, it would not. Applying the same interactivity adjustment using Prof. McFadden's conjoint survey to the Nokia MixRadio rates would result in a ratio of 1.3 ($5.69/$4.51), adjusting for offline listening, or 1.6 ($7.10/$4.51), adjusting for offline listening and unlimited skips. The corresponding rates would still support SoundExchange's rate proposal [ ]. *See* Hr'g Ex. SX-56 (Rubinfeld's interactive adjustment based on Prof. McFadden's conjoint).

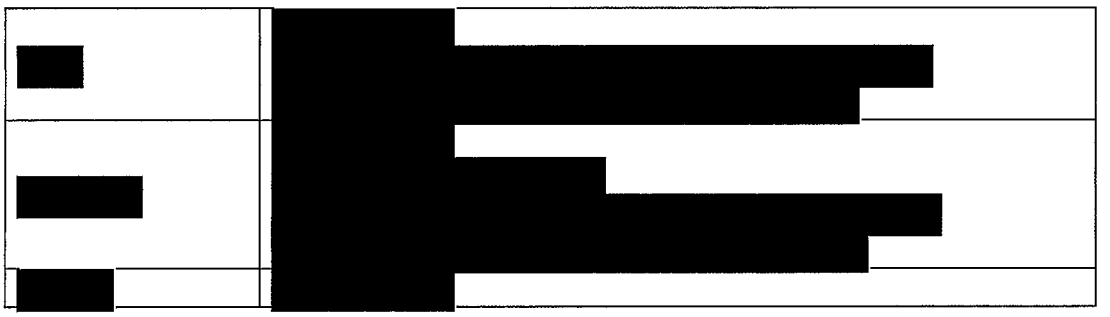
d. Rhapsody UnRadio

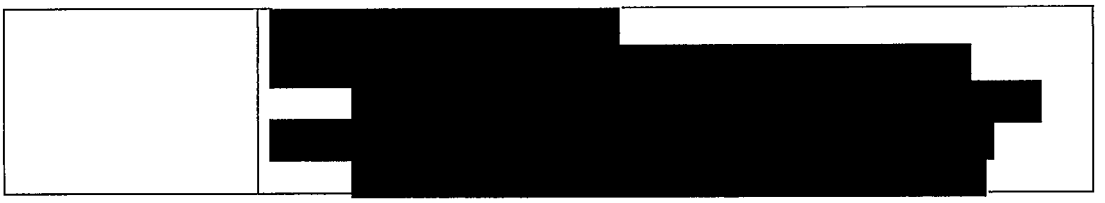
575. Again, ***all parties agree*** that Rhapsody UnRadio offers a programmed radio service that is *not* on-demand in the traditional sense. It does however offer the ability to save up to 25 songs for offline listening and a few additional offerings that exceed the statutory license. It has functionality that exceeds that permitted by the statute. NAB PFOF ¶¶ 525-27; IHM PFOF ¶¶ 415-16.

576. Again, much of what ***iHeart*** describes as extra-statutory functionality, such as "customize[d] individual artist stations by increasing the 'popularity' of songs played or decreasing the 'variety' of songs played" (IHM PFOF ¶ 416), is statutory functionality shared by iHeartRadio, Pandora, and SiriusXM Internet Radio. Nonetheless, the stated per-performance rates are informative as described below and, as NAB concedes, are higher on an average effective basis. NAB PFOF ¶ 530.

577. ***NAB*** again levies the argument that Rhapsody UnRadio is only a small fraction of the performances across all Rhapsody offerings and a percentage of all royalties Rhapsody pays. NAB PFOF ¶¶ 528-29. This is irrelevant for the same reasons describe above relating to Beats' The Sentence. Furthermore, NAB neglects that the UnRadio service *had just launched* in June of 2014 so the period of time it reviews is the first six months of the offering, not that of an established market service.

578. The rates for Rhapsody's UnRadio are:





Hr'g Ex. SX-29 ¶ 197 (Rubinfeld Corr. WRT).

579. Taken as a whole, these rates show that similar programmed or ad-supported offerings are licensed by willing buyers and willing sellers at rates that confirm SoundExchange's rate proposal and corroborate Prof. Rubinfeld's interactivity adjustment.

IV. PANDORA'S RATE PROPOSAL AND SUPPORTING EVIDENCE DO NOT REFLECT THE RATES AND TERMS THAT WOULD BE NEGOTIATED BY WILLING BUYERS AND SELLERS ABSENT THE STATUTORY LICENSE

A. Overview Of Pandora's Position

580. Far from presenting a "thick market" analysis, Pandora rests its entire rate proposal on a single agreement – its own agreement with the independent-only rights agency Merlin. This one agreement, which covers less than [ ] percent of Pandora's performances is no basis upon which to set the rates and terms that most willing buyers and willing sellers would agree to for a pivotal rate during this crucial time in the music industry. Nothing in Pandora's Proposed Findings of Fact proves otherwise.

581. Even were a single agreement a sufficient basis on which to determine the rates and terms for this proceeding – and it is not – Pandora's findings fail to demonstrate five necessary premises, each of which is discussed in further detail below:

582. First, Pandora attempts to prove that it operates in a distinct licensing market from interactive services. *See, e.g.*, PAN PFOF ¶¶ 20-26, 275-278, 301-309. In this proceeding, Pandora attempts to relegate its competition with interactive services to that which occurs on the "margin" and therefore separate itself from the larger marketplace for audio streaming services. PAN PFOF ¶ 337. Yet, there is a veritable mountain of evidence *from Pandora* that proves

otherwise. By failing to account for this competition, Pandora and its economist, Prof. Shapiro, fail to analyze the dynamics of the licensing market.

583. Second, Pandora cannot demonstrate that its Merlin license is a comparable product of a free market negotiation. Pandora does not even attempt to dispute that the agreement was directly influenced by the existence of the non-precedential, inadmissible Pureplay Settlement Agreement. Rather, all Pandora says is that the Merlin license may be influenced upward by the Pureplay statutory rates. PAN PFOF ¶¶ 164-171. This does not in any way establish that the Merlin license is the product of a free market, rather than a statutorily-based, negotiation.

584. Third, Pandora fails to show that the Merlin license is a representative or comparable agreement for the industry as a whole. This is not surprising. Almost by definition, the variation among willing buyers and willing sellers in the marketplace would render any single agreement insufficient to represent the thick market that currently exists for the licensing of sound recordings to audio streaming services. Whether or not a single agreement *could* represent the entire industry, the Merlin license – a license between the absolute largest webcaster and an independent-only rights agency covering a sliver of the webcaster's performances, all from independent record companies – is not such a license. Pandora's attempts to prove otherwise are meritless, including Pandora's attempts to draw comparisons to the very interactive service agreements it argues are licensed in a distinct and non-competitive upstream market. PAN PFOF ¶¶ 143-163. These attempts are belied by a record replete with testimony and documentary evidence confirming that the Merlin license is a truly *un*representative arrangement.

585. Fourth, Pandora repeatedly exclaims that its purported ability to "steer" users towards directly licensed music will inspire competition. *See* PAN PFOF ¶¶ 89, 116-122, 152-157, 181-187, 377-390. In so doing, Pandora breezes over the extensive record which undermines the importance of this steering. The record establishes that the Merlin agreement required a [ ], which can obviously and admittedly not be replicated across the industry. Pandora's back-up position, asserted by Prof. Shapiro – that the threat of steering alone is sufficient for its purposes – is a theory searching for actual support in the record. In fact, the only evidence of Pandora's actual experience with steering, as opposed to a litigation-driven experiment, undermines the credibility of Pandora's ability to steer or threaten to steer.

586. Fifth, Pandora contends that the Merlin license supports its rate proposal based upon Prof. Shapiro's interpretation of the value of the license. PAN PFOF ¶¶ 127-142. That interpretation, however, is based on a selective assessment of the license terms that looks at the license only through *Pandora*'s expectations. The absolute failure to account for *Merlin*'s expectations – evidenced both by multiple independent witnesses and contemporaneous documents – renders his analysis utterly unreliable. So too do the internal Pandora documents in the record which are inconsistent with Prof. Shapiro's assessment of Pandora's expectations. Moreover, and particularly since this is Pandora's first direct license and Merlin's first license with a webcaster, performance matters. The record evidence is clear: The license so far has been a failure, with the parties still grasping for meaningful implementation with [ ] left on its term. No willing buyer or willing seller would look at this license in any marketplace – actual or hypothetical – and fail to take notice of this fact. Yet, Prof. Shapiro and,

in turn, Pandora, chose to ignore these facts – committing a mistake that should not repeated by the Judges, given the significant stakes at issue here.

587. These points are each independent, sufficient reasons to reject Pandora's rate proposal and its flimsy assertion of benchmark support. There is also a fundamental flaw that infects Pandora's treatment of all of these points in its findings: the utter lack of reliance on actual marketplace evidence from Pandora's ordinary course of business documents. ***Over the course of 424 proposed findings of fact spanning 173 pages, Pandora cites to an internal Pandora business document only once – and even that one instance is a concession that consumer behavior is not as easily segregated as Pandora's findings would suggest.*** *See* PAN PFOF ¶ 336 (admitting that a Pandora internal market study [ ]). Given Pandora's entire support for its rate proposal based upon analysis of Pandora's business, Pandora's strategy, Pandora's expectations, and Pandora's licenses, the omission of references to Pandora's documents is damning.

588. The importance of this evidentiary deficit was identified by Pandora's own expert, Prof. Shapiro. When asked why it was particularly useful to [ ], Prof. Shapiro replied that the Hr'g Tr. 2718:10-22 (May 8, 2015) (Shapiro). He added that he Hr'g Tr. 2716:22-2717:1 (May 8, 2015) (Shapiro). Such documents exist in the record, including key strategy presentations made to Pandora's Board of Directors. However, in making

a case based on its own business, Pandora conspicuously chose to ignore the [redacted] in the record.

589. Pandora's case boils down to the suggestion that the Judges base a decision that will set a crucial rate for the entire music industry and thousands of webcasters on Pandora's own expectations of a single trial license (referred to by Pandora's own CEO as a [redacted], Hr'g Ex. SX-2233) between the largest webcaster in the market and an independent-only right agency representing a sliver of Pandora's performances – a license which Pandora negotiated in the direct shadow of this proceeding and on the basis of non-precedential, settlement rates, and which Pandora has largely failed to implement and perform. Such a dubious precedent would and should never itself model the rates agreed to by most record companies or webcasters in the commercial music marketplace, whether actual or hypothetical. To avoid facing this reality, Pandora, both in the hearing and in its findings, tightly spins a yarn between the litigation-created testimony of its experts and the litigation-created testimony of its executives. However, when tested against the actual documents in the record, from Pandora and otherwise, the yarn unravels.

B. Pandora's Strategy Documents Reveal That Pandora Unquestionably Competes Directly And Pervasively With Services Offering On-Demand Functionality

590. SoundExchange has addressed issues of convergence between webcasting services and other audio streaming services at length both in its proposed findings and these reply findings. *See* SX PFOF Section V.C; *supra* SX Reply PFOF Section II.B.2. This section will address a different but related issue: what Pandora's internal business documents reveal about its own view of competition in the marketplace, especially between Pandora and services that offer on-demand functionality.

591. Because Pandora's denial of this competition in this proceeding is its foremost response to evidence of convergence, this deep dive obviously relates to that issue. However, the relevance of the discussion extends beyond convergence and cuts to the integrity of Pandora's presentation: If Pandora cannot establish that (a) competition between non-interactive and interactive services is only at the margins and (b) does not impact licensing efforts by non-interactive services, Pandora simply cannot support or defend its anemic proffer of the Merlin license. Pandora's internal business documents confirm that both of these positions are untenable.

1. Pandora, And Prof. Shapiro, Attempt To Draw Sharp Lines That Do Not Exist In The Marketplace For The Use of Sound Recordings By Audio Streaming Services

592. Pandora characterizes services that include on-demand functionality (such as Spotify, Rhapsody, and Rdio) as distinct from Pandora and other webcasters solely based on the formers' offering of additional on-demand functionality. PAN PFOF ¶ 21. By and large, Pandora contends that it does not compete with and operates "in a fundamentally different market" than services with on-demand functionality. PAN PFOF ¶¶ 20-26; *see also* PAN PFOF ¶¶ 275-278, 301-309. In fact, Pandora contends that it "competes primarily with terrestrial radio, satellite radio, and other webcasters for market share within the 80% of all listening that is lean-back; other music providers (such as interactive streaming services) compete for the 20% of listening that is lean-forward." PAN PFOF ¶ 24. Put another way, Pandora largely denies competing with interactive streaming services for music listening. *See* PAN PFOF ¶¶ 301-309.

593. Such a basic division of markets for music listening should be easily reflected in or demonstrated by Pandora's business documents. Yet, the only business document Pandora cites is a portion of acknowledgment of [redacted]

[redacted] (PAN PFOF ¶ 336), an acknowledgement that fundamentally undermines Pandora's suggestion that the competition for listening can be so easily segregated.

594. When confronted by this evidence, Pandora's CFO, Mr. Herring admitted there was competition between Pandora and interactive on-demand services but characterized it as only "marginal" to Pandora's business, concerning only what Pandora calls "a smaller, more dedicated group of music listeners" that is at "the margins of" the business of Pandora and interactive streaming services. PAN PFOF ¶ 337.

595. Based on this assertion and though Prof. Shapiro presumably had complete access to all of Pandora's business documents, Prof. Shapiro attempted to draw a hard line – quite literally, in his often-referenced "Figure 5" – between what he conceived of as separate and distinct "upstream" markets. PAN PFOF ¶¶ 275-278.

596. In attempting to construct segregated upstream markets, *see* PAN PFOF ¶ 277, Prof. Shapiro did not analyze the extent of competition for music listening between Pandora and services that offer on-demand functionality in the downstream market. Rather, he assumed and admitted there was, at the very least, an [redacted] Hr'g Tr. 2625:23-2626:2 (May 8, 2015) (Shapiro). Nor did he perform any economic analysis about how competition in the downstream market affects the viability of his assertion that there are segregated upstream markets. Nor did he perform any analysis about whether there is competition between Pandora and services offering on-demand functionality in the upstream market for licensing sound recordings.

597. At a minimum, Pandora's ordinary course business documents should be able to confirm or deny whether and how Pandora's business strategy takes into account Pandora's competition with services that offer on-demand functionality and, in turn, confirm or deny

whether Prof. Shapiro has properly characterized the nature of the upstream and downstream markets for music licensing and listening. That Pandora chose not to reference, much less analyze, such documents in its findings speaks volumes to the extent to which its litigation presentation in this proceeding matches its ordinary course view of the marketplace.

598. This issue cuts to the core of Pandora's benchmark analysis, as championed by Prof. Shapiro. The economics of Pandora's presentation assume that there are two distinct upstream markets and consequently that the dynamics that influence negotiations between on-demand services and record labels differ from those that affect the negotiations between webcasters and record labels. *See, e.g.*, PAN PFOF ¶ 277. Furthermore, Pandora's rate proposal rests upon a single license negotiated under the shadow of its statutory license and thus Pandora's conjecture about what would happen in the absence of that license depends entirely on what market forces would operate on licensing negotiations for that service. This is not just about whether Pandora can rebut the importance of convergence. Rather, the issue of Pandora's close competition with on-demand services, or, as it would assert – a lack of such competition outside the "margins" of its business – is a threshold issue for the viability of Pandora's rate proposal and Prof. Shapiro's economic analysis.

599. As discussed below, Pandora's own business documents belie the market characterization it has presented in testimony to the Judges. Those documents, by the admission of the champion of Pandora's case, are the best and most appropriate evidence of *Pandora's* view of the competitive marketplace.

2. Pandora's Crucial "Board Of Directors" Strategy Day Presentation Evidences The Close Competition Between Pandora And Services Offering On-Demand Functionality

600. On October 30, 2014, mere weeks after Pandora filed its direct case in this proceeding, Pandora convened a "Strategy Day" for its Board of Directors. Hr'g Ex. SX-269

(Board of Directors "Strategy Day" Presentation). This is the [ ] that Pandora has held such a strategy day during Mr. Herring's twenty-six month tenure at the company. Hr'g Tr. 3456:1-6 (May 13, 2015) (Herring).

601. There is no question that Pandora's Board of Directors serves an important role in its business decisions. The information presented to the Board of Directors is

Hr'g Tr. 3455:11-25 (May 13, 2015) (Herring).

602. By Prof. Shapiro's own standards, this is the best evidence to apply – better than evidence created for litigation. That is because it comprises

Hr'g Tr. 2716:22-2717:19, 2718:10-22 (May 8, 2015) (Shapiro). Under this standard, there are likely no documents in the record that are more informative of Pandora's view than the materials provided for [

603. Furthermore, the presentation is also significant because it is contemporaneous with the evidentiary record in this proceeding. As it was presented to the Pandora Board of Directors mere weeks after Pandora's filing of its direct case and shortly after the public announcement of the Merlin license, Pandora's proposed benchmark, the presentation provides a clear and very timely view into Pandora's internal thinking.

604. Thus, a detailed examination of the Strategy Day presentation provides excellent evidence into Pandora's honest assessment of the competitive marketplace, that Pandora and Prof. Shapiro chose to all but ignore this presentation is itself telling.

605. The agenda for the Strategy Day presentation included [redacted] Hr'g Ex. SX-269 at 2. Of those materials, the first two agenda items – [redacted] – are the most relevant to this proceeding.

[RESTRICTED GRAPHIC]

Source: Hr'g Ex SX-269 at 2.

a. Strategy Overview

606. [*Id.* at 5.

607. Pandora presented a [ ] *Id.* As part of its

overview, Pandora defined the [redacted] *Id.* at 7.

608. Pandora also presented a [redacted] as follows:

RESTRICTED GRAPHIC

[redacted]

Source: SX-269, at 6.

609. This overall strategy analysis makes two important references to competition. First, Pandora identifies a key weakness being that Pandora's [redacted]

[redacted]."] *Id.* Mr. Herring testified that the reference to [redacted] Hr'g Tr. 3459:14-3460:5 (May 13, 2015) (Herring). Second, Pandora identifies one of its three overall threats as [redacted] Hr'g Ex. SX-269 at 6. In each instance, the reference emphasizes competition from services with *greater* functionality than Pandora.

610. Also, the analysis makes four additional observations that undermine the market characterization in Pandora's findings. First, Pandora identifies another weakness as [redacted] *Id.* That suggests that Pandora will not as easily commandeer the dashboard as Pandora's findings predict. *See* PAN PFOF ¶ 136. Second, one of Pandora's core strengths is its [redacted] thereby emphasizing the important contribution that record company sound recordings have to its service. Hr'g Ex. SX-269 at 6. Third, and of particular relevance to Pandora's benchmark presentation, Pandora's [redacted]. *Id.* This undercuts the assumption that Pandora is a representative buyer, as discussed *infra* Section IV.D.4. Fourth, Pandora identified one of its core weaknesses as [redacted], which Mr. Herring identified as the [redacted]. Hr'g Ex. SX-269 at 6; Hr'g Tr. 3458:12-14 (May 13, 2015) (Herring). By distinguishing [redacted]

[redacted] as a weakness of Pandora, Pandora suggested that it is in a different negotiating position with [redacted]

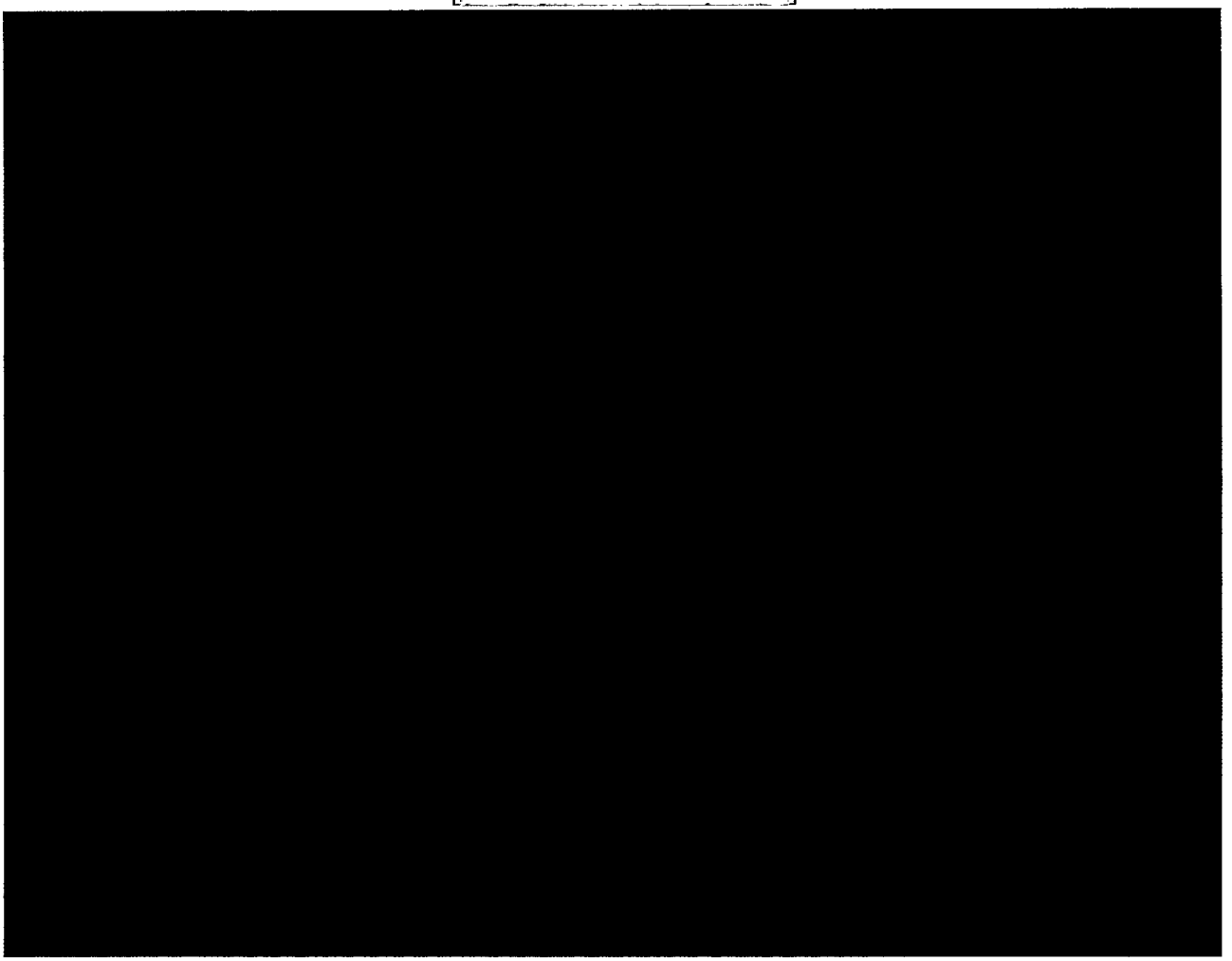
b. [redacted]

611. The Strategy Day presentation then continues with [redacted]. This section of the presentation deserves special attention because it is the most directly relevant part of the entire Strategy Day presentation to the central question of who Pandora competes with for consumer listening. *See* SX-269 at 8-61.

612. Nowhere in this examination of Pandora's competition for listening does Pandora suggest that services offering on-demand functionality only compete at the margins of Pandora's business. Rather, *every* single competitor comparison in the entire analysis of the market for consumer listening includes at least [redacted].

613. Like the strategic overview, this section begins with a [redacted]:

[RESTRICTED GRAPHIC]



Source: Hr'g Ex. SX-269, at 10

614. Pandora identified a number of its [redacted]], not to simply "other internet, satellite, and terrestrial radio providers" (Hr'g Ex. SX-269 at 13; *see* PAN PFOF ¶ 22). Notably, the [redacted]

[redacted] *Id.* at 14.

615. Pandora utilized [redacted]

616. [redacted]

617. [redacted] at 17. This implies that a service that can appeal to consumer appetite for both [redacted] will be well-positioned to compete for a significant portion of the consumers who want [redacted]

[redacted] or a lean-back listening experience. In fact, they are relatively well-positioned to compete against a service that can *only* provide an [redacted]] experience.

[RESTRICTED GRAPHIC]

Source: Hr'g Ex. SX-269 at 17.

618. This was the one and only reference that Pandora made to the Strategy Day presentation – or to any internal Pandora strategy document – in its findings. PAN PFOF ¶ 336.

[redacted]

[redacted] This confirms the very real threat that services that offer on-demand functionality but also offer [redacted] do pose to Pandora in the competition for consumer listening.

619. In identifying Pandora's third weakness – that Pandora [redacted] *Id.* Notably, in response to this comparison, Pandora is considering an initiative to [redacted] *Id.* at 48. This further confirms that Pandora is seeking to compete with [redacted] by generating [redacted] for listening *within* the platform.

620. This competition is not at the margins of Pandora's business. For instance, the Strategy Day presentation focuses on Pandora's [redacted]

[redacted]

621. [redacted] at 19-20; 175. [redacted] *Id.* at 176. Thus, it is evident that Pandora recognizes that the control offered by services that include on-demand functionality like [redacted] may be a threat to its listening [redacted]. *See id.* at 179-181 (comparison to [redacted].) In fact, [redacted] *Id.* at 177. Indeed, in response to this issue, Pandora has proposed several [redacted] *Id.* at 183. The focus on this weakness, including a further deep dive into the issue later in the day (*id.* at 162-183) underscores just how important the close competition between Pandora and services that offer on-demand functionality is to Pandora's business and strategic thinking.

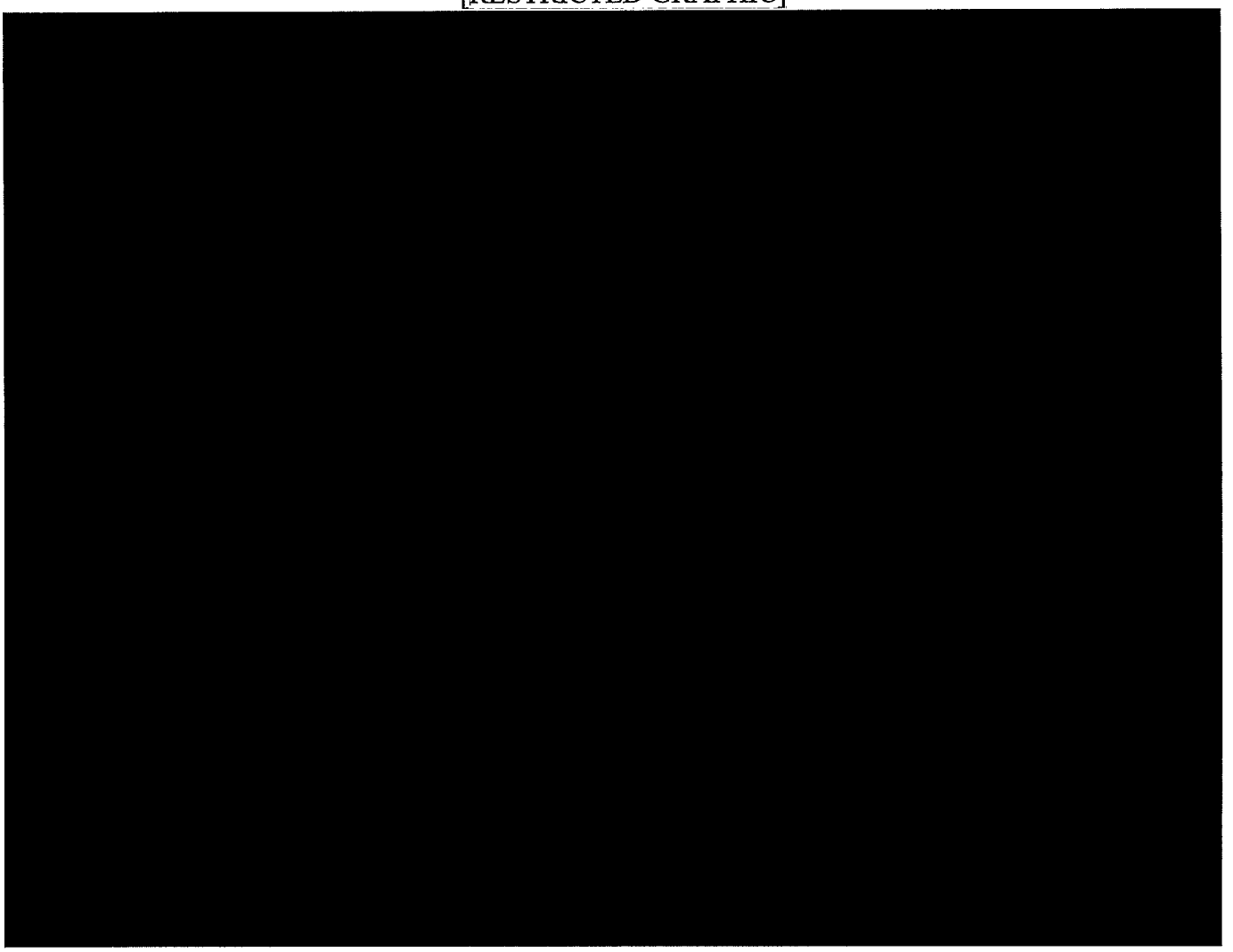
622. With respect to the "Opportunities" part of Pandora's Listeners analysis, Pandora identified [redacted]

[redacted] suggesting, at a minimum that users do not make the hard distinctions that Pandora suggests between webcasting services and services that offer on-demand functionality. *Id.*

623. Pandora also recognized that it [redacted] further affirming the record evidence suggesting that record companies have a rational preference for on-demand subscription models. [redacted] at 25.

624. [redacted] at 10. Given Pandora's litigation position that on-demand services can only compete for listeners at the margins of Pandora's business, and that Pandora's primary competitors are terrestrial, satellite, and internet broadcasters, one would expect Pandora's business presentation to focus on the spending of these broadcasters. Not so. The Strategy Day presentation instead points to [redacted]. *Id.* at 26.

[RESTRICTED GRAPHIC]



Source: Hr'g Ex. SX-269 at 26.

625. Based on this analysis, Pandora defined its [ ]

[RESTRICTED GRAPHIC]

Source: Hr'g Ex. SX-269 at 31.

626. These operating priorities reflect Pandora's view of the competitive landscape in three ways. [

[redacted] *Id.*

627. The close competition for listeners between Pandora and on-demand services is confirmed by Pandora's [redacted] Under the view espoused by Pandora's proposed litigation findings that there is a strong division between users who want a lean-back versus a lean-forward listening experience (e.g. PAN PFOF ¶¶ 337-339), there would be no need for study or consideration of this action, because Pandora could comfortably operate its core lean-back business with no need to worry about how users compare Pandora to [redacted]

[29] This initiative appears to mark a decided break with Pandora's prior focus on only word of mouth marketing. *Contra* PAN PFOF ¶ 7.

[redacted]

[redacted].] This initiative further confirms that Pandora is making decisions concerning its product offering – decisions important enough to discuss with its Board of Directors – by [redacted].]

628. The picture of competition for music listening portrayed by Pandora's analysis of the market for listeners in its Strategy Day presentation to its Board of Directors stands in stark contrast to Pandora's litigation characterization of the same in its findings and witness testimony.

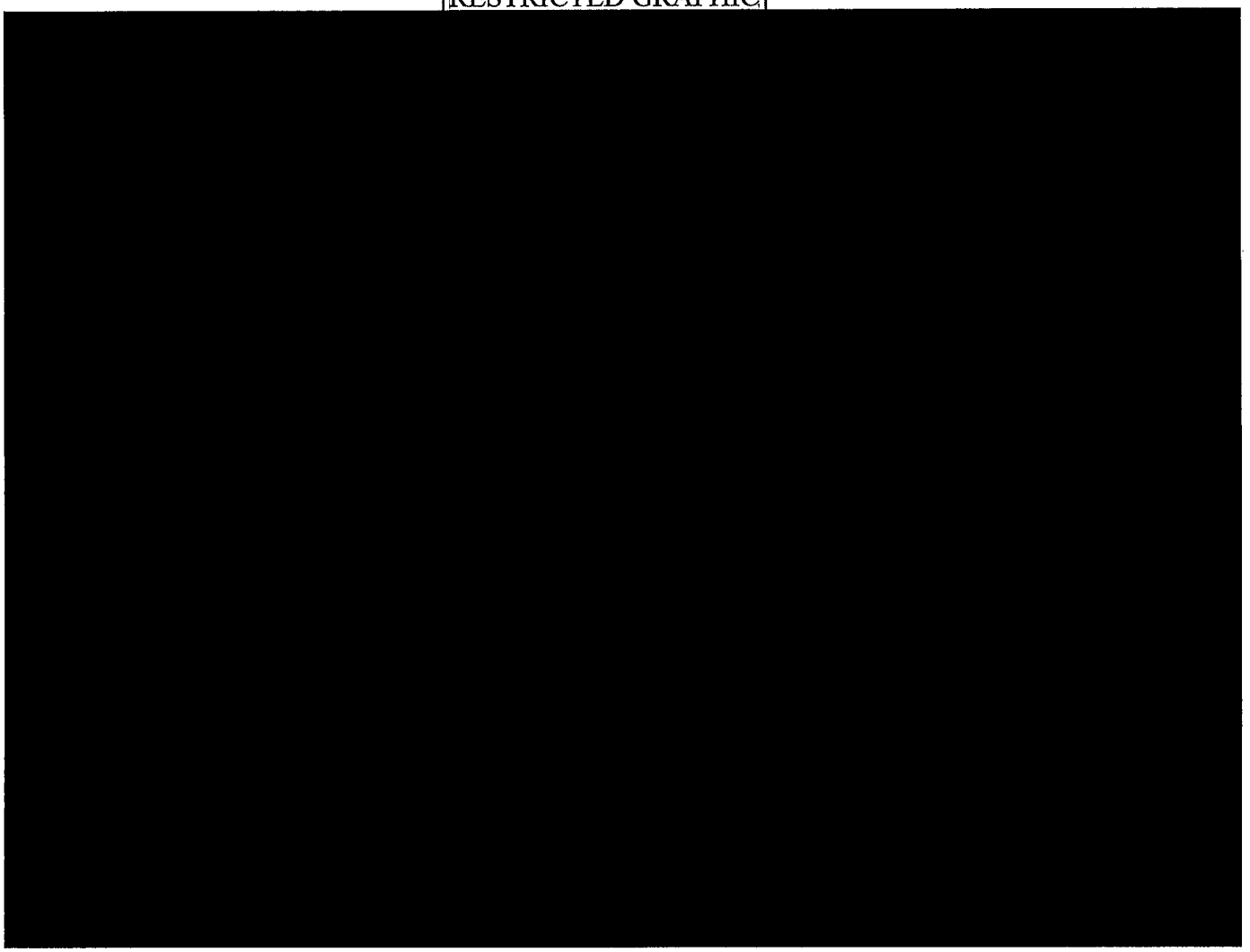
- *c.* [redacted]

629. Pandora's [redacted] presentation is an examination of [redacted]

[redacted]. *See* Hr'g Tr. 3475:11-13 (May 13, 2015) (Herring) (noting this is about [redacted]); *id.* at 3476:3-4 [redacted] Put another way, this is an examination of the forces that affect Pandora's ability to obtain content and Pandora's relationship with content owners, which is effectively what Prof. Shapiro characterizes as the "upstream market" for sound recordings.

630. As with the prior segments of the Strategy Day presentation, this discussion begins with an identification of Pandora's strengths, weaknesses, opportunities, and threats – [redacted] Those are as follows:

[RESTRICTED GRAPHIC]



Source: Hr'g Ex. SX-269 at 64.

632.

[redacted].] [redacted] at 64. In recognizing this opportunity, Pandora verily recognizes that direct licensing discussions do not adhere to Prof. Shapiro's artificial dotted line between non-interactive and interactive services. *Id.* Put another way, while on-demand functionality may render a service ineligible for statutory licensing, that functionality does not itself segregate upstream markets for direct licensing.

[redacted] Third, Prof. Shapiro and Pandora suggest that Pandora operates in a separate upstream market that is walled off from all the competitive dynamics they criticize with respect to interactive service licensing negotiations. This is flatly denied by the [redacted]

[redacted]

635. [redacted]

[redacted] These strengths, however, are characteristics that distinguish Pandora from other webcasters. Thus, the analysis confirms that Pandora is not a typical webcaster and, contrary to Pandora and Prof.'s Shapiro's assumption, a benchmark analysis based solely on a Pandora license is not representative of willing buyers in the webcasting market.

[redacted]

638. [redacted] If, as Pandora and Prof. Shapiro contend in this proceeding, Pandora operates in a truly

separate upstream market for the licensing of sound recordings, there would be no reason for Pandora [ ].

639. Finally, Prof. Shapiro and Pandora contend that the market evidence suggests that major record labels would accept the same deal terms as Merlin accepted. PAN PFOF ¶¶ 143-163. Pandora's own internal Board of Directors presentation recognizes instead that [.]

d. [ ]

640. In stark contrast to the Pandora presentations concerning [ ] raises the questions of Pandora's profitability and business model – questions that Pandora entirely ignores in its proposed findings of fact. *See* Section II.B.4, *supra.* As implied by Pandora's conspicuous omission, issues of Pandora affordability are among the least relevant issues to the questions raised by this proceeding.

641. Nevertheless, even in this space, the Strategy Day presentation recognizes that [

[RESTRICTED GRAPHIC]

Source: Hr'g Ex. SX-269 at 121.

642. Taken as a whole, Pandora's Strategy Day presentation to its Board of Directors defines a clear point of view concerning the market environment in which Pandora competes for listeners and attempts to negotiate licenses for sound recordings. That view diverges greatly from the one described in Pandora's findings, and that view corroborates the market characterization espoused by SoundExchange. Despite providing perhaps the best example of ordinary course-of-business documents that define Pandora's business strategy at the highest levels, the Strategy Day presentation is almost altogether ignored by Pandora in its findings. Such an obvious omission, at a minimum, raises serious and substantial questions about the

market descriptions and assumptions that underlie Pandora's proposed findings and litigation presentation as a whole.

643. This presentation is not alone but given the deep dive above into the best reflection in the record of Pandora's strategy at its highest labels, SoundExchange will not discuss the sweeping swath of Pandora business documents at the same length. Nevertheless, as referenced below, they confirm that Pandora's Strategy Day presentation view of the marketplace is a more accurate view the marketplace than the once concocted in Pandora's findings.

3. Pandora Falsely Assumes Services Can Only Offer Either "Lean Back" Or "Lean Forward" Listening Experiences

644. Pandora's findings are overly simplistic in their description of the Pandora listening experience and position in the digital music ecosystem. PAN PFOF ¶¶ 14-27. The way Pandora describes the music ecosystem, a service must either be a "lean-back" non-interactive service or a "lean-forward" interactive service. PAN PFOF ¶¶ 20-21. This confuses distinctions in characterizations of types of listening with distinctions in the types of services. Whether services could have been so easily distinguished in past rate periods, such characterizations make little sense in the present and even less sense moving into the next rate period.

645. Despite Pandora's attempts to define "lean forward" or active listening as only on-demand listening, *see* PAN PFOF ¶ 21, a user can "lean forward" without picking his or her individual song. For instance, a user can "lean forward" on Pandora by adding variety to a station, by providing a thumbs up or thumbs down, or by creating a new station altogether. Each of these activities requires a listener to do more than just sit back and listen.

646. In fact, Pandora's own branding documents defy the stark characterization that the only "lean forward" activity is an on-demand selection of a song. *See* Hr'g Ex. SX-2356 at 1

[redacted]

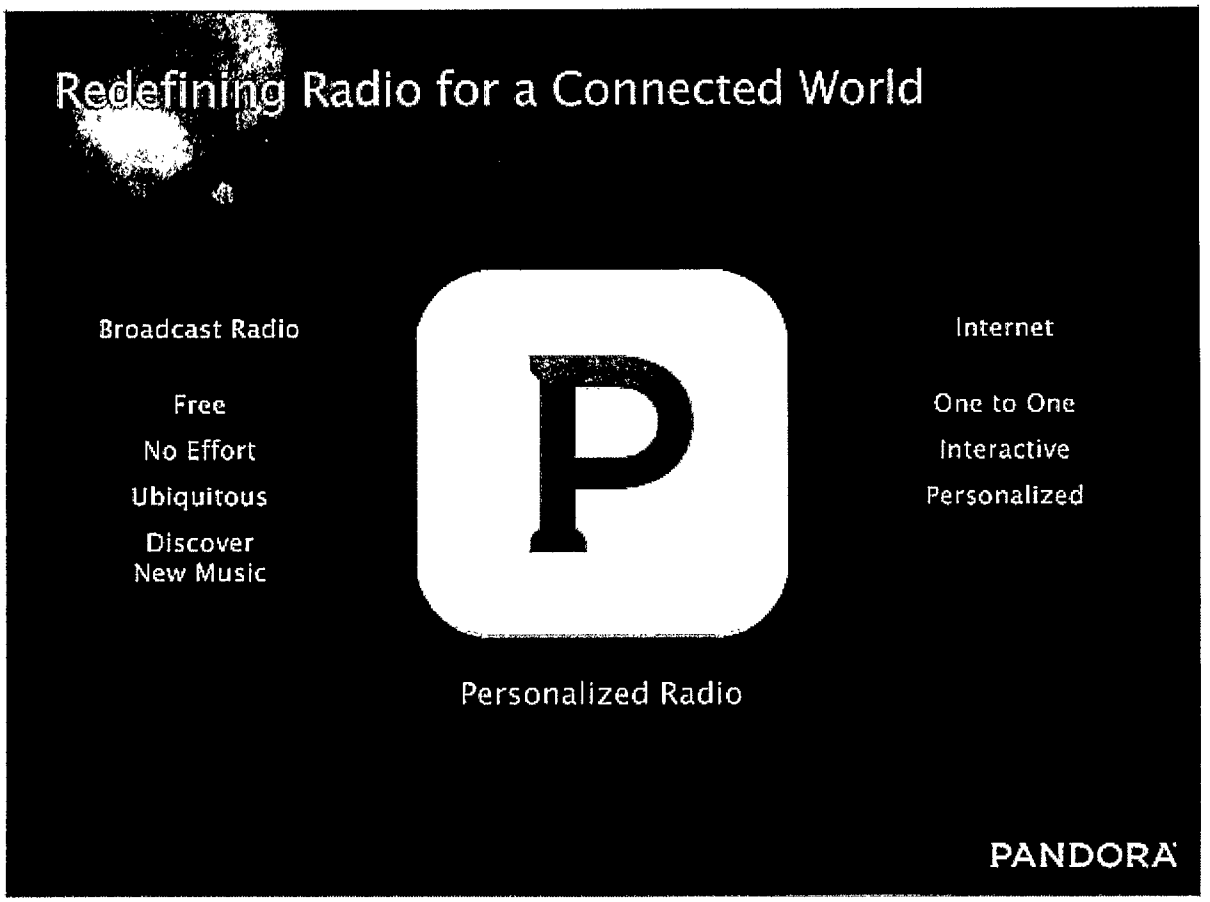
[redacted]

[redacted]]). These forms of lean-forward or lean-in activity are necessary to improve Pandora's product. *Id.* [redacted]

[redacted]]). Pandora even refers to [redacted]

[redacted] Hr'g Ex. SX-278 at 13. In fact, Pandora acknowledges that because of its use of collaborative filtering and collective intelligence, a user's indication of preference will affect both to refine an individual user's playlist and to influence the playlists of other users. *See* PAN PFOF ¶¶ 11-12.

647. The very investor presentation that Mr. Herring attached to his testimony recognizes that Pandora is attempting to redefine what it means to be "radio" by making it "one-to-one," "interactive," and "personalized." Hr'g Ex. PAN 5012 at 7.



Source: Hr'g Ex PAN 5012 at 7.

648. The point here is not to suggest that Pandora is offering "on demand" functionality across its entire service. Rather, Pandora is becoming *more* "interactive" in the sense it uses in its own documents: Pandora is increasingly looking to add features, functionality, and a user interface that adds to a user's perception of or actual control over her listening experience. And, it is doing so, as Pandora's founder Tim Westergren has observed, because consumers have expectations of interactivity and personalization, so services like Pandora are making a huge amount of effort to innovate, including in emerging platforms like the auto dashboard. *See* Hr'g Ex. SX-2369 at 3 (stipulating to September 2014 statement as if made under oath).

649. These expectations are confirmed by Pandora's own internal research[30] which has found that [.] Hr'g Ex. SX-268 at 9. In fact, [*Id.* This is especially notable because it extends to Pandora's free users, not just users who are or were willing to pay for a Pandora monthly subscription. *Id.*

[RESTRICTED GRAPHIC]

Source: Hr'g Ex. SX-268 at 9.

[30] The [ ] for Pandora's study are reported in the same presentation. *See* Hr'g Ex. SX-268 at 15–17.

650. In addition, Pandora is expanding its on-demand listening experiences, such as its Pandora Premieres and Pandora Presents programs, and [.] *See* Hr'g Ex.SX-263 at 10. [*Id.*

[RESTRICTED GRAPHIC]

Source: Hr'g Ex. SX-263 at 6.

651. These realities are driving Pandora to consider [Hr'g Ex. SX-263] is with respect to Pandora's core existing subscription business, which does not offer on-demand functionality, suggesting that the pull of the market is not limited to a binary question of whether to offer on-demand functionality or not. This is particularly significant because these are some of Pandora's most valuable users; [.] *Id.* at 3.

652. This is the essence of the competition for listeners SoundExchange has described and Pandora (in this litigation) has denied. These subscribers are not listeners who are paying for an on-demand listening environment, as Pandora's subscription plan does not provide on-demand functionality. Nevertheless, Pandora is considering altering its business to address [the Hr'g Ex. SX-263 *Id.*

[RESTRICTED GRAPHIC]

Source: Hr'g Ex. SX-263 at 23.

653. Also, Pandora's conflation of types of listening with types of services also misstates the competition that Pandora faces. For better or worse, Pandora does not simply compete or most closely compete with terrestrial broadcast radio. Put another way, Pandora does not merely compete with "lean back" services for 80% of the market and "lean in" services for 20% of the market. Pandora's suggestions to the contrary (PAN PFOF ¶¶ 24-26) are inconsistent with Pandora's own internal characterization of the listening offered by services that include on-demand functionality.

654. The reality is that, whether or not Pandora wants to, it now competes with *one-stop music services* that operate platforms providing users with *both* lean-back and lean-forward listening experiences.

655. Pandora makes much ado about the idea that witnesses refer to Pandora in some contexts as "radio", *see* PAN PFOF ¶ 23. However, Pandora's own [redacted] from December 2013 tracks eleven services total and for [redacted] Hr'g Ex. SX-1652 at 2, 4, 6, 15, 19. Even the two exceptions offer playlisting.[31] *Id.* at 12, 24. [Another Pandora strategy presentation, one which evaluates the business models and price points of competitors, recognizes that services with on-demand functionality also have "radio." *See* Hr'g Ex. SX 263 at 23 (listing Spotify, Rdio, Deezer, Rhapsody, Slacker, Google, and Apple as "competitors" and nothing that each has "radio".)

656. This competitive reality was eloquently stated by Mr. Herring, who noted that he sees services with on-demand functionality ["[redacted]

[redacted]

[31] The two exceptions were [redacted], which was said to have [redacted] and [redacted], which was said to have [redacted] Hr'g Ex. SX-1652. at 12, 24. The other services tracked in the report – [redacted] – do not offer on-demand functionality and were therefore only characterized as [redacted] *Id.* at 8, 10, 17, 22.

[redacted]

Hr'g Tr. 3448:15-3449:9 (May 13, 2015) (Herring)

657. Mr. Herring confirmed that he has seen [redacted] Hr'g Tr. 3449:13-3450:7 (May 13, 2015) (Herring). By any account, including Pandora's account, that is the market for music consumption that Pandora and other webcasters primarily participate in.

658. Mr. Herring described the marketplace reality even better than Pandora's internal strategy document. There are not "lean-back" services and "lean-in" services, they are one- stop music streaming services that are attempting [redacted] Even when prompted by his counsel on re-direct to [redacted] Mr. Herring added that [redacted]]." Hr'g Tr. 3555:5-13 (May 13, 2015) (Herring). These services are not solely

defined by their offering of on-demand functionality. As exemplified by its Board of Directors Strategy Day Presentation and Mr. Herring's own testimony, Pandora [redacted].

659. Judge Strickler asked exactly the right question on this point to Mr. Fleming-Wood of Pandora. Mr. Fleming Wood recognized that "there are a lot of people who listen to radio and want to control their music-listening experience at some point . . . the group that wants both of those things looks for services that can satisfy both of those needs." Hr'g Tr. 6140:10-19 (May 27, 2015) (Fleming-Wood). Judge Strickler asked whether "[t]o the extent that the interactive services are now developing things that are more noninteractive in nature . . . does that put you more in competition with those services because they could be sort of, if you will, one stop shopping?" *Id.* at 6141:10-16. Mr. Fleming-Wood's answered no, claiming users care about the "initial intent" when selecting a service and there are "controls" even on the playlist abilities and he also noted that the growth of Pandora and Spotify side-by-side shows they are not competing directly. *Id.* at 6141:2-6142:18; *id.* at 6141:2-6.

660. Mr. Fleming-Wood's answer is incorrect insofar as it overstates the control on radio parts of Spotify. On cross examination, Mr. Fleming-Wood was shown that the user controls on Spotify Radio are limited in a number of ways and do not allow unlimited or on-demand control. *See* Hr'g Tr. 6145:2-6147:24 (May 27, 2015) (Fleming-Wood). Similarly, Mr. Fleming-Wood confirmed that an internal Pandora presentation [redacted] Hr'g Tr. 6182:12-6183:18 (May 27, 2015) (Fleming-Wood); Hr'g Ex. SX-1719 at 12-13.

661. This answer is also inconsistent with the evidentiary record. Pandora's internal business documents provide a very different answer to Judge Strickler's important question. Pandora recognizes that there is [Hr'g Ex. SX-278 at 7. In fact, Pandora's internal research indicates ["] and, as discussed *supra*, [ ]. *Id.* at 9-10; Hr'g Ex. SX-1678 at 8 ([ ]).

662. Pandora's internal evidence also confirms the competition, not correlation, between Pandora and Spotify. Pandora's internal analysis suggests that [" "]. Hr'g Ex. SX-1670 at 16; *see also* Hr'g Ex. SX-2367 at 7 (Presentation to CEO McAndrews notes that] Indeed, more broadly speaking, the research of Mr. Fleming-Wood's own group suggests that ["] Hr'g Ex. SX-1679 at 15.

[RESTRICTED GRAPHIC]

Hr'g Ex. SX 1679 at 15.

4. Pandora's Own Findings Acknowledge That There Is One Upstream Market For the Licensing of Sound Recordings to Audio Streaming Services

663. Pandora contends that there are two separate and distinct upstream markets for the licensing of recorded music – one for services offering on-demand functionality and another for statutory webcasters. *See, e.g.* PAN PFOF ¶¶ 277-278. But when convenient, Pandora's Findings of Fact cite to documents and evidence that show that market participants do not view the upstream market as two distinct markets.

664. *First*, Pandora contends that, despite its dominant share of webcasting, it is a representative buyer in the upstream market because Merlin labels generate revenue from other uses of their sound recordings, including from on demand services. PAN PFOF ¶¶ 173-175. Thus, Pandora argues, it cannot exert undue "buyer-side" market power because it is a "small percentage of the Merlin Labels' overall revenues." *Id.* ¶ 175. However, if Pandora is correct that on demand buyers reduce its market power in the upstream market, this suggests that there is, in fact, competition between Pandora and on demand buyers in the upstream market. In other words, Pandora and on demand buyers are part of the same market for licensing sound recordings.

665. *Second*, Pandora argues that the timing and duration of the Merlin does not matter because "*everybody* in the industry is well aware that direct licenses can potentially be used as benchmarks in this proceeding." *See* PAN PFOF ¶¶ 176-177. But to support this assertion, Pandora cites to evidence from the licensing negotiations of *on-demand* services. Again, in discussing the state of the market, Pandora treats on demand services and webcasters as part of the same market.

666. *Third*, Pandora contends that major record labels would accept the same rates and terms as Merlin did [redacted] PAN PFOF ¶¶ 158-163. Once again, Pandora has chosen to cherry pick evidence from the licensing of interactive services when it suits Pandora's purpose, yet pretends that there are two distinct upstream licensing markets when it does not.

667. *Fourth*, Pandora attempts to demonstrate that the Merlin license is the result of competition by comparing the position of the Merlin labels in this negotiation to the position of the Merlin labels in licensing negotiations with services that offer on-demand services. *See* PAN

PFOF ¶¶ 119, 182. In PAN PFOF ¶ 119, Pandora quotes from a [ ][32] Hr'g Ex. PAN 5099 at SNDEX0316398. In that e-mail, [ ] This e-mail demonstrates the competition between record labels is for licensing terms in a *unified upstream market* that includes on-demand services. Similarly, the testimony quoted by Pandora in PAN PFOF ¶ 182 is comparing the position of Merlin and independent record companies more generally in this negotiation as opposed to what may happen "normally" in licensing negotiations with other services – including services offering on-demand functionality.

668. Pandora cannot have it both ways. If Pandora and Prof. Shapiro are correct that, as a matter of economics, that there are distinct and separate markets for the licensing of sound recordings to non-interactive and interactive services, and those markets are separated by hard and fast lines, then Pandora also fails to answer these important criticisms. If the opposite is correct, then Prof. Shapiro's analysis starts from a fundamentally incorrect premise – there are

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[32] Notably, the email cited in PAN PFOF ¶ 119 does not support that paragraph's claim that Merlin's members entered the agreement to be first movers. Mr. Hansen was not discussing the Merlin license that was executed, but, instead, was discussing Pandora's [ ]. Hr'g Ex. PAN 5099 at SNDEX0316397-99; Hr'g Ex. SX-104 at 2. Mr. Hansen's email confirms several important things. First, from the outset of the negotiation, the specific promotional and marketing commitments were valuable to Merlin labels, [Hr'g Ex. PAN 5099 at SNDEX0316398. Second, [.] In his e-mail Mr. Hansen noted This e-mail shows that Merlin's labels would not have entered the agreement [ ] Third, Pandora was not, in the eyes of Merlin labels, a representative willing buyer. [

not distinct upstream licensing markets that separate interactive and statutory webcasting services.

669. Especially in light of the actual marketplace evidence contained in Pandora's own documents, it is noteworthy that Prof. Shapiro conducts no independent economic analysis to identify the separate upstream markets. The most he suggests is that the statutory license would or should separate the upstream markets between interactive and non-interactive services. But, in the relevant hypothetical market, such a separation would no longer exist.

5. The Existence Of Broad-Based Competition Critically Undermines Pandora's Position

670. Consistent with SoundExchange's analysis of the convergence in the marketplace, the record evidence, including and especially Pandora's own documents, confirms that there is broad-based competition for listening between webcasters such as Pandora and services that offer on-demand functionality. Furthermore, the existence of such competition, as well as a raft of corroborative record evidence, suggests that the so-called "upstream" market for the licensing of sound recordings is not neatly segregated between statutory webcasters and interactive services.

671. This critically undermines Pandora's position. Pandora makes no attempt to account for the effects of convergence in the marketplace on what willing buyers and willing sellers would agree to. Pandora's analysis instead depends on assuming convergence does not exist. Pandora has no contingency analysis to corroborate its rate proposal in the event that the Judges find there is competition between interactive and statutory services.

672. Furthermore, because the record supports a finding of convergence, this amplifies the incredible problems of relying upon only one single license – the Pandora-Merlin license – discussed *infra* because it compounds the factors that remain unaccounted for in Prof. Shapiro's

analysis and requires consideration of how the choice to license sound recordings to interactive services would affect the hypothetical rate willing buyers and willing sellers would agree to. Neither Pandora nor Prof. Shapiro attempts such analysis.

673. Finally, a finding of broad-based competition, or convergence, provides a powerful foundation to answer a crucial question concerning the Merlin license: In the absence of the statutory license, what rates would willing record companies agree to, including and especially the record companies comprising the [ ] of Pandora performances who have *not* agreed to the rates and terms of the Merlin license. Notwithstanding Pandora's attempts to wish away the mountain of record evidence suggesting the rates inferred by the Merlin license would be much higher, the presence of competition between interactive services and Pandora speaks volumes to how record companies would be most likely to respond.

C. The Merlin License Is Not The Product Of Free Market Negotiations

674. Pandora's proposed findings of fact largely gloss over a second threshold issue concerning its sole reliance on the Merlin license: The Merlin license is the product of statutorily-based negotiations, not free market negotiations. To rely upon the license would therefore require the Judges to impermissibly account for the rates and terms of the Pureplay Settlement Agreement. *See* SX COL Section III; SX PFOF ¶¶ 510-517. Even were such reliance legally permissible, the Merlin license was negotiated directly in the shadow of Pandora's existing statutory license and therefore cannot inform the rates and terms of a hypothetical marketplace negotiation. SX PFOF ¶¶ 154-156, 517. Were it possible for a license attempting to modify the existing statutory rates to escape this criticism, the record does not support such reliance here: Pandora has made no attempt whatsoever to adjust for the overwhelming regulatory shadow which smothers the Merlin license.

675. These were all issues that SoundExchange addressed in detail in its proposed findings of fact and conclusions of law. Nor were they in any way a surprise, as SoundExchange made clear before, during, and after the hearing that it objected to consideration of the Merlin agreement on these bases.

676. Rather than engage these issues, Pandora simply ducks the issue altogether in its findings. The most Pandora attempts to say is that these substantial criticisms should not matter because, Pandora contends, the "statutory license acts as a magnet to pull rates up." PAN PFOF ¶¶ 164-171. As discussed below, this contention is both insufficient and incorrect.

1. Pandora Acknowledges The Agreement's Dependence On The Inadmissible Pureplay Settlement Agreement

677. SoundExchange has provided a comprehensive account of the many ways in which the Merlin license requires the Judges to take into account the non-precedential and inadmissible rates and terms of the Pureplay Settlement Agreement. SX COL Section III; SX PFOF ¶¶ 510-517. This reliance is evidenced in key license terms, including the [ ], and a mound of contemporaneous documents and unrebutted witness testimony that evidence the undeniable role the Pureplay Settlement Agreement played in the negotiation of the Merlin license. SX PFOF ¶¶ 510-517.

678. There is no need to re-hash that discussion here because this is not a point Pandora denies at any length. In fact, Pandora's proposed findings acknowledge several times over that the Pureplay Settlement Agreement forms the backdrop of the Merlin license negotiations. *See e.g.* PAN PFOF ¶¶ 99, 169 (describing the Merlin agreement as a choice based upon the Pureplay rates). Pandora also does not dispute that the statutory license—in this case,

the Pureplay Settlement Agreement—influenced the Merlin license. PAN PFOF ¶¶ 169-170; *see also* Hr'g Tr. 4652:6-9 (May 19, 2015) (Shapiro) ("So the pureplay rates clearly had a – were, in both parties' minds, the way they negotiated the Merlin agreement, that is, Pandora and Merlin, and I think it's fairly plain."). The disagreement between the parties, as discussed *infra*, is whether the existence of the Pureplay Settlement Agreement distorted the negotiation between willing buyers and sellers or whether, as Pandora contends, the Pureplay Settlement Agreement only functioned as a "magnet" to lift the rates of the Merlin license.

679. That disagreement is beside the point with respect to SoundExchange's position that reliance upon the Merlin license—particularly reliance *solely* upon the Merlin license—would run afoul of Congress's express prohibition embodied in the Webcaster Settlement Act. SoundExchange raised that objection prior to the hearing and made clear that the same objection would be addressed in its proposed findings of fact and conclusions of law. Even though Pandora was provided with ample notice that this was an important threshold issue with respect to the Merlin license, Pandora conspicuously avoided any discussion of the issue. Regardless, the record is incontestable that it is impossible to rely upon the Merlin license without taking into account the rates and terms of the non-precedential Pureplay Settlement Agreement.

2. The Overwhelming Evidence In The Record Demonstrates That The Merlin Agreement Reflects The Operation, Not The Absence, Of The Statutory License

680. SoundExchange has identified a veritable mountain of evidence in the record, including both witness testimony and contemporaneous documents, to demonstrate that the Merlin license is the product of statutorily-based, not free market, negotiations. SX PFOF ¶¶ 154-156, 517-526. Prof. Shapiro even admitted that it is "obvious" that the statutory license impacted the Merlin license. SX PFOF ¶ 511. Pandora's proposed findings do not deny this impact.

681. SoundExchange has also explained at length how the impact of the shadow of the statutory license is an important factor in assessing the appropriateness of a proposed benchmark. SX PFOF ¶¶ 147-150. Pandora does not address the statutory shadow factor at all, much less consider the role of that factor with respect to the comparability of a proposed benchmark. Pandora's proposed findings and conclusions of law are entirely silent on the priority of considerations within a benchmark analysis, except to argue that there is an extra-statutory requirement of "effective competition."[33]

682. Because the Judges' remit is to determine the rates and terms to which most willing buyers and most willing sellers would agree *in the absence of the statutory license*, a direct license that is basically a modification of the existing statutory rates and terms—a license whose very existence is inextricably bound with the existing statutory rates—is unquestionably inappropriate as a benchmark. SX PFOF ¶¶ 147-148. Pandora does not deny this or suggest otherwise in its proposed findings. This is true irrespective of whether the statutory license pulls rates up or down from those that would be freely negotiated—the existence of a shadow effect, particularly one so directly felt, renders the license an exceptionally poor candidate for a reliable benchmark.

683. That is exactly the situation presented by the Merlin license. Pandora's proposed findings repeatedly refer to the Merlin license as an "injection of competition into the marketplace" or as "competition at work" (*e.g.* PAN PFOF ¶¶ 168, 184), but fail to assess what the Merlin labels were competing against or, more appropriately, comparing the Merlin license against. Pandora readily admits that the alternative to the Merlin license for Merlin labels was

[33] SoundExchange has addressed this argument separately in its reply conclusions of law. *See* SX COL at Section II.A.

Pandora's continued reliance on the Pureplay rates and terms. *See* PAN PFOF ¶ 169. This was not a situation where Pandora was pitting multiple record companies against each other, in large part because no one—not a single record company except for Naxos, a small Merlin label who wanted a different direct payment arrangement than Merlin—has taken Pandora's bait. As such, the operative comparison for Merlin at the time was to the existing Pureplay rates. Hr'g Tr. 4652:9-12 (May 19, 2015) (Shapiro) (Pandora and Merlin "both knew if they didn't cut a deal, then Pandora would continue to pay the pureplay rates to Merlin.".) The more appropriate characterization, then. is not one of competition "at work" or between record companies, but instead that Merlin and Pandora agreed to a modification of the arrangement otherwise defined by Pandora's existing statutory rates and terms.

684. There can be no serious dispute on the severe effect of the statutory shadow on Pandora's proposed benchmark, as the record includes:

- Undisputed witness testimony establishing that the negotiation of this license was unique because the alternative to reaching a direct license was a well-defined set of rates and terms. *See* Hr'g Ex. 13 ¶ 26 (Lexton WRT) (unusual negotiation because we knew Pandora could walk away and Pandora knew the exact price of walking away – the Pureplay rates and terms); Hr'g Ex. 31 ¶¶ 9-10 (Wheeler WRT) (describing license as a "statutory rate experiment"); Hr'g Tr. 7155:6-12 (June 2, 2015) (Secretly Group labels [redacted]).
- The license terms bear a direct and/or derived relationship from the existing statutory license. SX PFOF ¶¶ 510-518.
- The negotiating documents in the record demonstrate that material changes were made to the Merlin license *because* of the rates and terms in the existing statutory license. *See, e.g.*, Hr'g Ex. SX 106 at 1 (noting bifurcated rate structure is part of Pureplay license).

3. Pandora's "Magnet" Argument Fails To Account For The Effect Of The Statutory Shadow On The Merlin License

685. Pandora's singular attempt to deflect this issue is an argument that suggests the statutory license operates as a "magnet," making it unnecessary to adjust downwards to account for the effect of the statutory shadow. *See* PAN PFOF ¶¶ 164-171.

686. Pandora's position ignores the basic reality that when a direct license is negotiated from and tied to the statutory license, the issue is not merely one of adjustment—the issue is a threshold consideration of whether the license says *anything* about a hypothetical negotiation without the statutory license. As SoundExchange previously explained, when a direct license (such as the Merlin license) is negotiated with the plain alternative being statutory rates and terms, the entire character of the negotiation is different and diverges from the marketplace negotiation contemplated by the statute. SX PFOF ¶¶ 520-522.

687. The first premise of Pandora's argument is that because statutory licenses provide a ceiling on what a service will pay, an agreement below that ceiling is a recognition that the statutory license is "above the competitive level." PAN PFOF ¶ 165. There is no dispute about the first part of that statement—statutory licenses create an artificial ceiling on what a service will pay because, excepting variations in terms or methods of payment, the service alone controls the option to force a nonconsensual license at the specified statutory rate. SX PFOF ¶ 154, 521. What does not follow, however, is Pandora's suggested implication—that a direct license below that ceiling indicates that the ceiling itself was above competitive prices.

688. First, at the hearing, Prof. Shapiro made an important concession on this point. In stating his belief that the "competitive rate, *at least regarding Merlin and Pandora, is [for] that pair [] below the statutory rate*." Hr'g Tr. 4652:21-23 (May 19, 2015) (Shapiro) (emphasis added); *id.* 4755:19-4756:9 (Shapiro noting that "above the competitive rate" refers to the specific record company/service pair and the statement just means "a rate that those two parties

would negotiate given that . . . all other deals are set at 14"); *id.* at 4757:6-4757:16. Thus, the reference to a rate being "above the competitive level" simply means that the rate is above the statutory rate the service would pay in the absence of a direct license; Prof. Shapiro and Pandora do not—nor could they—contend that the rate was "above the competitive level" for the market as a whole.

689. The ceiling itself—the statutory rate—is the very distortion of a free market negotiation, particularly when combined with the existence of a license that is nonconsensual for sellers. That is the core of Prof. Talley's analysis, which demonstrated that the true effect of the statutory license is to crowd out consensual transactions above or near the statutorily-defined rate. SX PFOF 155. Record companies operating in a statutory license environment cannot withhold their content from any service that wants to operate under the statutory license. Given this lack of choice, direct licenses negotiated under the ceiling of statutory rates merely indicate that the record company has agreed to one of the two statutorily-defined options: (i) the rate that is defined by the nonconsensual statutory license itself or (ii) the rate that is offered by the service as an alternative to the statutory rate.

690. Pandora's argument also assumes that the effective rates agreed to in the Merlin license, when properly valued, are not equal to or higher than the rates Pandora would otherwise pay under the statutory license. To the contrary, the uncontroverted testimony of three prominent independent record company executives and one of Merlin's principal negotiators is that Merlin and its label members expected the totality of their consideration under the license would result in effective rates at or above the Pureplay rates. SX PFOF ¶ 588, 613-656.

691. To truly assess whether this was an agreement where record companies, in Pandora's words, "unilaterally" act to "undercut" the statutory price, one would need to assess

the record companies' expectations of value—something which neither Pandora nor Prof. Shapiro attempt to do. *See* SX PFOF ¶¶ 595-598.

692. Pandora makes a half-hearted attempt to suggest the Merlin labels knew the statutory rate was too high and were driven by competition to lower it. *See* PAN PFOF ¶¶ 166-167. In attempting this point, Pandora mischaracterizes Mr. Barros's testimony. Mr. Barros testified that given his record company's heavy repertoire of [.] Hr'g Ex. SX 1 ¶¶ 11-12, 27-28 (Barros WRT); Hr'g Tr. 6511:17-20, 6534:2-19; 6538:18-20 (May 28, 2015) (Barros). Mr. Barros did not testify about whether the statutory rate was too high or too low. Nor did he retreat from his original position concerning the importance of compensation for performances of pre-1972 recordings. What Mr. Barros said was that, [Hr'g Tr. at 6538:21-6539:13 (May 28, 2015) (Barros).

693. This testimony is entirely consistent with Mr. Barros's general position [ ]. Hr'g Ex. SX 1 ¶¶ 26-28. By receiving compensation [.] Prof. Shapiro himself recognizes that direct license payments for performances of pre-1972 recordings would, in practice, adjust the effective statutory rates implied by a benchmark upward. *See* PAN PFOF ¶¶ 128-129.

694. Most of the remainder of Pandora's "magnet" argument can be summarized thusly: if one assumes the Merlin license represents an effective rate below the prevailing statutory rate, then the likely effect of a statutory license is to pull the effective rate upwards. PAN PFOF ¶¶ 168-170. This misses the point and assumes the conclusion. By virtue of the fact that the statutory rate operates as a ceiling of comparison, it is nearly impossible to assess (or assume) that the statutory license pulls the effective rate in any direction.

695. The Merlin negotiation was already perversely bounded by the existence of the statutory license prior to any evaluation of an upward or downward "magnet" effect. The uncontroverted testimony of independent record company witnesses is that the very nature of the Merlin license negotiation was defined by the parameters of the Pureplay Settlement Agreement and Pandora's operation thereunder. SX PFOF ¶¶ 517-526. Put differently, the presence of a statutory rate will create a de facto framework bounding the willingness to accept of any record company negotiating with a statutorily eligible webcaster; the constraint of that framework has a far more profound effect than any asserted effect *within* the marginal zone of negotiation within that framework. Consider the hypothetical: Company X is willing to accept $50 for its product. A binding law ABC says the product must be sold at $25 if a buyer meets certain conditions. Buyer Z, who meets those conditions, offers $20 for the product. After negotiation, X and Z agree to a price anywhere between $20.01 to $25. In such circumstances, would it be proper to say law ABC had a "magnet effect" on the negotiation when the very existence of ABC compels X to sell at $25 even if X's actual willingness to accept is double that price? This need not be a hypothetical: Mr. Van Arman explained at the hearing that [redacted]

[redacted] *See* Hr'g Tr. 7161:11-22 (June 2, 2015) (Van Arman). Once that framework is imposed upon the negotiation, it is largely unimportant if not irrelevant whether the final negotiation results in an effective rate that is slightly higher or lower than the one originally offered by the statutory webcasting service. Yet, this latter effect, and not the framework shift, is what Pandora has fixated on as a "magnet" effect.

696. Specifically, Pandora's "magnet" argument both assumes the existence of a statutory rate and takes for granted that the statutory rate has not undercut the willingness to accept of record companies by its very existence. But correcting for the effect of the statutory shadow is not about correcting for the effect *assuming the existence of the statutory license*, it is about correcting for the effect assuming the opposite—the *absence* of the statutory license. Pandora makes no such attempt to provide such an adjustment or correction.

697. Pandora's final attempt to address the shadow of the statutory license is a thinly veiled suggestion that those who have opted in to the Merlin license (in particular, Mr. Van Arman) should not be able to question its comparability as a benchmark. PAN PFOF ¶ 171. This makes no sense, particularly if one believes, as Prof. Shapiro does, that a party's expectations are important. The party in the best position to discuss the comparability of a proposed benchmark, the seller's expectations under that benchmark, or what the benchmark reflects (or does not reflect) about a seller's willingness to accept is, in fact, the seller.

698. The very essence of Mr. Van Arman's rebuttal testimony shows the error in Pandora's reasoning. Pandora conflates the question of whether to opt in to a direct license that modifies existing statutory rates with the question of whether that same direct license is a comparable benchmark to determine statutory rates. Those are not the same questions. Hr'g Ex.

SX 30 at 2-3 (Van Arman WRT). In fact, if one were to assume as Pandora does, one would have the statutory "race to the bottom" scenario because direct licenses that are merely modifications *because of* the statutory pronouncement are mistaken for licenses that would occur in the *absence* of that statutory pronouncement. *Id. See* SX PFOF ¶¶ 586-587.

699. Pandora's stab at Mr. Van Arman is telling in a different regard: Pandora's position is that if a record company opted in to the Merlin license, the record company should not be able to deny that the license is a comparable benchmark to the statutory license. PAN PFOF ¶ 171. This is obviously wrong for four reasons.

700. First, a record company who receives a first-mover advantage would lose it if the same license was applied to all record companies. To export the Merlin license without all the attendant benefits of that license—including the so-called "first mover advantage"—is to change the competitive regime itself and to erase the purported competitive benefit altogether. Put another way, a competitive regime based on a "first mover" advantage is an inappropriate basis for a statutory regime that allows no first mover. If anything, using such precedent will strip away the directly licensed seller's "first mover" advantage—since the rate will apply universally. That is why Mr. Van Arman clearly and eloquently testified that the Merlin license could only be a benchmark if [ ] Hr'g Tr. 7156:1-7157:2 (June 2, 2015) (Van Arman).

701. Second, by implication, the converse of Pandora's position is true: When a proposed benchmark involves only some sellers—here, involving less than [ ]—there is plainly a difficulty in applying that benchmark against the remainder of the market who has expressed through their action *no* willingness to accept the proposed "competitive benefit." They are not first movers and in many instances, not movers at

all. There is a further inequity of using a first-mover license against those sellers as they would be, in the words of Mr. Van Arman, "doubly denigrated." *See* Hr'g Ex. SX 30 at 5 (Van Arman WRT).

702. Third, the record is loaded with evidence demonstrating that from the outset, Merlin and its labels did *not* believe the Merlin license should be a benchmark for the statutory license. *See, e.g.*, Hr'g Ex, SX 13 ¶ 25 (Lexton WRT); Hr'g Ex. 102 at 2 ([" [redacted]])

703. Fourth, the implicit premise behind Pandora's position is that the record company has obtained some benefit from the direct license. However, the uncontested testimony in this proceeding is that there is precious little operational certainty and even less performance under the Merlin license. *See, e.g.*, Hr'g Ex. SX 30 at 7-9 (Van Arman WRT); Hr'g Ex. 13 at 24-25 (Lexton WRT); SX 31 at 9-11 (Wheeler WRT). The lack of implementation of promised benefits, provision of data, reporting, etc. has been so poor that both Mr. Wheeler and Mr. Van Arman testified at the hearing that they [redacted] Hr'g Tr. 7158:23-25 (June 2, 2015) (Van Arman) [redacted]); Hr'g Tr. 7109:13-7110:2 (June 1, 2015) (Wheeler). For instance, at the time written rebuttal testimony was submitted in this proceeding (February 2015), [redacted] .] Hr'g Tr. 7107:9-7108 (June 1, 2015) (Wheeler).

704. In any event, Pandora's attempt to characterize the massive effect of the existing Pureplay rates on the Merlin license as merely a "magnet" is utterly unavailing. It fails to respect the obvious record evidencing that the Merlin license is defined by—and would not exist but for—the existence of Pandora's statutory license.

4. This Proceeding Directly Impacted The Negotiation Of The Pandora-Merlin Agreement

705. The Merlin license was negotiated by Pandora, at least in part, to create evidence for this proceeding. *See* SX PFOF ¶¶ 563-575. Pandora does not dispute this.

706. Nor can Pandora dispute this. As SoundExchange detailed in its proposed findings of fact, [[redacted],] Pandora negotiated this license with the idea in mind that it could serve as evidence to support Pandora's case before the Judges. *See* SX PFOF ¶ 567. This is confirmed by [redacted]. SX PFOF ¶¶ 567-575.

707. Pandora's primary response to this is that "*everyone*" in the industry is aware of this proceeding, including Merlin. PAN PFOF ¶¶ 177, 179. There are several obvious problems with this position. First, there is a drastic difference between a general awareness that a license might be used before the Judges and an intentional strategy to engage in direct licensing to create evidence for the proceeding. [[redacted]], Pandora's motivation was the latter. *See* SX PFOF ¶ 567-575; *see also* Hr'g Ex. SX-2367 at 16 ([redacted]

[redacted]"]).[34]

708. Second, Merlin's awareness that Pandora might try to present this license in this fashion in this proceeding is unimportant. Any such awareness does not offset the strategic behavior by Pandora: the salient issue is not whether Pandora was able to overcome Merlin's skepticism of Pandora's motivations, but whether the license reliably reflects the negotiation between willing buyers and sellers. To the extent there is strategic behavior to create evidence for the proceeding, it is utterly irrelevant if both parties are aware of the possibility. At least with respect to the interactive service benchmarks, there are many licenses from many sellers and buyers, making the possibility of strategic behavior much smaller, *and* because there are so many licenses, there is an ability to recognize whether any individual license appears skewed. By contrast, the Merlin license has no baseline or peer comparison. It was Pandora's first license, one of only two direct licenses for Pandora, and the only one for which Pandora has done any meaningful analysis or assessment.

709. Third, the possibility that the shadow of the proceeding has influenced if not infected the core of a license is particularly problematic in an instance where the license is the webcaster's first ever direct license and only license proffered as a possible benchmark. *See* SX PFOF ¶¶ 563-565. In such circumstances, the distortion risk of strategic behavior is at a maximum because the negotiating party knows that it will rest its entire case for an *industry-wide* license based upon only the single negotiation.

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[34] Mr. Fleming-Wood testified that SoundExchange Exhibit 2367 was [redacted] Hr'g Tr. 6162:14-18 (May 27, 2015) (Fleming-Wood). The briefing was prepared [redacted] *Id.* at 6166:7-20.

710. Pandora's response is also inconsistent with Prof. Shapiro's characterization of segregated upstream markets. To prove its "everyone does this" proposition, Pandora relies upon evidence concerning negotiations over licenses with interactive services, *see* PAN PFOF ¶ 177, despite its stalwart insistence that it would be "cynical" to assume that the market forces operating in one so-called upstream market interact with or are present in the other upstream market. Pandora cannot have it both ways.

711. The distortionary effects of this proceeding are felt more acutely when the benchmark is a single agreement, rather than a thick market of many agreements from many buyers and sellers. SX PFOF ¶¶ 563-564. This is yet another reason to prefer a thick market analysis to a single-benchmark proposal. In the former, if, as Pandora argues, everyone in the industry is truly aware of the litigation risk of any particular license, the analysis of many such licenses is likely to minimize any artificial bias created by strategic considerations. By contrast, in a single-benchmark analysis, there is no safety valve to guard against such bias. Given that the rates and terms set in this proceeding will determine an *industry-wide* rate for five full years, the consequences are simply too great to risk reliance on a single license, especially where the proponent of the license concedes that one of its considerations was the strategic evidentiary value of the license in this proceeding.

D. Pandora Failed To Demonstrate That The Merlin License Is Representative Of The Rates and Terms Most Willing Buyers And Willing Sellers Would Agree Upon

1. Representativeness Is A Core Concern For Assessing A Proposed Benchmark

712. The representativeness of a proposed benchmark speaks directly to its comparability to the target market at issue in the proceeding. While the threshold question for comparability of a benchmark is its ability to account for the absence of the statutory license, the

additional issues of representativeness cannot be overlooked. *See* SX PFOF ¶¶ 527-580. In prior proceedings, the Judges have considered representativeness as an important reason to embrace or disregard benchmarks proposed by one or more parties. SX PFOF ¶¶ 528-529. The question of whether a proposed benchmark is representative is acutely important where, as here, a participant has proposed that a *single* license serve as the basis for the adoption of its entire rate proposal.

713. Indeed, the Merlin license is a single, experimental agreement struck between the largest webcaster and a group of independent record labels covering a sliver of performances related to [redacted] Pandora altogether fails to analyze many of the representativeness concerns raised by this license, including those discussed in detail in SoundExchange's proposed findings. *See* SX PFOF ¶¶ 527-580. Instead, Pandora breezes through its analysis of representativeness addressing only the question whether major record labels would agree to the same or different terms. PAN PFOF ¶¶ 143-163. Even on that issue, Pandora ignores what the evidentiary record, including its own business documents, demonstrate: in a hypothetical or actual negotiation with Pandora, major record labels would not agree to the same terms as Merlin did.

2. A Single Agreement Based On A Single Negotiation Is Not Representative Of The Entire Marketplace

714. Almost by definition a benchmark based on a single agreement is not a "thick market" benchmark. In fact, Pandora makes only one reference to a "thick market" in its proposed findings – and that is with regard to SoundExchange's proposed benchmarks. *See* PAN PFOF ¶ 72. This is not surprising because Pandora fixates on a single license agreement. What is surprising, however, is Pandora's utter failure to address whether a *single* license based on a *single* negotiation is representative of the *entire* marketplace. It is not.

715. SoundExchange has addressed in detail the representativeness problems raised by fixating on only a single agreement, instead of considering a broad range of agreements. *See* SX PFOF ¶¶ 358-364, 586-587.

716. An additional consideration is that the Merlin license involves the dynamics of only a single negotiation. There may be any number of unrepresentative circumstances influencing that negotiation. For instance, much of the serious negotiation of the Merlin license occurred *after* the commencement of this proceeding and at the same time that Pandora was preparing its written direct case for this proceeding. Mr. Herring was supervising the negotiation of the Merlin license at the same time that Pandora's lawyers and economists were building its litigation case and drafting Mr. Herring's testimony.

717. Similarly, a single license captures a snapshot in time and reflects only those market forces at the time of its negotiation—here, the first eight months of 2014. The license cannot reflect or represent the various dynamics in the marketplace that are present between other buyers and sellers; nor can it reflect the market forces operating in the time period before the negotiation commenced or after the license's execution.

718. Moreover, because Pandora has put only one license at issue, it is impossible to confirm the representativeness of the license. Because it is the *only* license, there is no way to know whether the license was an outlier or in step with the general licensing market.

3. Both Pandora And Merlin Viewed This As A [redacted] License That Is Not Representative Of The Entire Marketplace

719. The representativeness issues posed by a single-license benchmark are compounded when that single license is untested and experimental. Because the Merlin license is based upon Pandora's *first* direct license with a record company, there is cause for concern about its experimental nature. SoundExchange marshaled the evidence confirming the

experimental nature of the Pandora license in SoundExchange's direct findings. SX PFOF ¶¶ 576-580. Put into the words of Pandora's CEO, the license is but a [redacted] and in the words of Pandora's Chief Scientist *after* the license was executed, it was [redacted] SX PFOF ¶¶ 577-578.

720. Pandora's own findings suggest that the Merlin license is the start of a "much larger much broader strategy" for direct licensing. PAN PFOF ¶ 178. In other words, this license is Pandora's trial run. In the words of Mr. McAndrews, Pandora's CEO, [redacted] a sentiment that Mr. Herring testified that [redacted] Hr'g Ex. SX-2233 at 1; Hr'g Tr. 4247:15-4248:4 (May 18, 2015) (Herring). There is no problem with Pandora engaging in new and experimental initiatives in an attempt to forge new paths in its business. But, such new and experimental initiatives are untested and cannot form the sole basis of a five-year industrywide rate.

721. Thus, even if a single license benchmark could be sufficiently representative, the record evidence undercuts any suggestion that *this* single, *experimental* license is sufficiently reliable or representative to shoulder the analytical weight of the industry. To do otherwise would require assuming that a first-time buyer and unique seller were able to price the value of sound recordings exactly correct in their trial run at licensing. That assumption is contradicted by the evidence in this proceeding – including by the statements of high-ranking executives contemporaneous with the announcement of the Merlin license.

4. Pandora Is Not A Representative Willing Buyer

722. Pandora makes only a cursory attempt to prove that it is a representative willing buyer in asserting that Pandora is the same "willing buyer" because it is a non-interactive

service. PAN PFOF ¶¶ 98, 100. Recognizing the obvious criticism leveled by Prof. Rubinfeld that Pandora is a rather "uniquely situated buyer," (*see* Hr'g Ex. SX 29 ¶¶ 65, 68-69 (Rubinfeld Corr. WRT)), Pandora makes a curious attempt at establishing its representativeness among webcasters. It fails.

723. Pandora argues that it is not a uniquely situated buyer and did not exert any undue buyer-side market power because Pandora "accounts for only some 5% of the revenues received by Merlin Labels in 2013 for the licensing of their music in the United States." *See* PAN PFOF ¶¶ 173-175.

724. As a preliminary matter, this assertion is entirely inconsistent with Prof. Shapiro's characterization of the "upstream licensing market" as distinct between non-interactive and interactive services. This argument rests on the premise that they are one in the same. That Prof. Shapiro contends that Pandora's buyer-side market power in licensing is reduced because of its revenue position vis-à-vis *all* licensing is a stunning and crucial admission. Even if Pandora and Prof. Shapiro stubbornly refuse to concede their proffered Figure 5 fiction, they concede that market power is impacted by the overall licensing/revenue position thereby undercutting the purported segregation of upstream markets.

725. Furthermore, this short-shrift assertion that Merlin labels have other sources of revenue is not a meaningful analysis of how the position of a uniquely situated buyer, such as Pandora, affected the terms of the Merlin license. As Prof. Talley explains, the surface observation concerning revenue fails to truly engaged in any analysis of the buyer side of the negotiations between Pandora and Merlin. *See* SX PFOF ¶ 534.

726. Pandora's assertion is not merely cursory, it also fails to answer the representativeness question, which is not simply limited to whether Pandora had buyer-side

market power. The question stands: is Pandora, as the behemoth of non-interactive webcasting, representative of most non-interactive webcasters? The record reveals that the answer is no. *See* SX PFOF 529-533. Pandora's executives openly testified to the true uniqueness and competitive strength of Pandora among webcasting services. *See, e.g.*, Hr'g Tr. 3433:3-3435:15 (May 13, 2005) (Herring).

5. Merlin Is Not A Representative Seller

727. Pandora expends some effort, discussed in greater detail below, attempting to defend the representativeness of a benchmark that includes sound recordings from only independent record companies. *See* PAN PFOF ¶¶ 143-163. What Pandora fails to do, however, is defend the representativeness of a license negotiated with Merlin.

a. Merlin Has Unique Institutional Motivations

728. SoundExchange analyzed whether Merlin, a global rights agency serving only independent record companies, is a representative seller to the hypothetical marketplace. SX PFOF ¶¶ 535-53. It is noteworthy that Merlin had three unique motivations in this negotiation that differentiate Merlin from record companies, who are the willing sellers of the hypothetical marketplace. *Id.* ¶¶ 551-53. Furthermore, its membership eligibility restrictions, which preclude participation by major record companies, mean that, by definition, Merlin will be uniquely situated from record companies in the hypothetical marketplace, which would include majors. *Id.* ¶ 535.

729. Pandora does not account for any of these structural or institutional distinctions that would differentiate a negotiation by Merlin from a negotiation undertaken by a record company.

b. Merlin Cannot Represent A Major Record Company's Willingness To Accept

730. The closest Pandora gets to these points is to argue that because Merlin [redacted], Merlin must be a representative seller. PAN PFOF ¶¶ 158-163. However, comparing existing licenses is *not* the same as conjecturing whether major record companies would agree to the same terms (or what they would do) if presented with the same license.

731. Nor does it account for any distinctions in the sequence of bargaining. Merlin is not normally a "first mover." *See, e.g.,* Hr'g Ex. SX 102 at 3 [redacted]); Hr'g Ex. PAN 5099 at 1 [redacted]). There is no evidence in the record, including Prof. Rubinfeld's analysis of Merlin's interactive licenses which Pandora now seeks to rely upon[35], which evaluates whether Merlin is able to negotiate comparable terms as major record companies when Merlin moves first. The only real information is that, practically speaking, Merlin has moved first and no one, except a single Merlin member label, has moved after them.

732. There is no reason to speculate one way or another on the issue of representativeness. Pandora had their own documents, discovery from Merlin, and four separate independent record witnesses to cross-examine and/or depose. Any deficits of representativeness at this point should be squarely born by Pandora for failing to prove that the Merlin license can represent *most* willing buyer-seller transactions.

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[35] Pandora again relies on the interactive service agreement to support its argument that the Merlin license is representative and, in the process, undermines Prof. Shapiro's constructed "wall" between the purportedly separate upstream licensing markets for non-interactive and interactive services. Here, Pandora's analysis is literally the mirror image of the interactive service benchmark that it rejects. Prof. Rubinfeld explains that the licensing practices in the interactive service market inform what would happen in the hypothetical marketplace. Pandora argues that Merlin's licensing practices in the interactive service market inform whether it is representative in the hypothetical market.

733. The Judges have squarely recognized that a benchmark based solely on licenses with independent record companies raises fundamental questions of representativeness. Such a proposal may have "surface appeal" but on "closer examination" there is a weakness to isolating only one license "as a data set." *SDARS II*, 78 Fed. Reg. at 23063.

734. SoundExchange provided an exhaustive discussion of this issue in its proposed findings of whether an organization that, by definition, only represents independent record companies would negotiate a license that is representative of a major record company. None of this evidence was anticipated or addressed in Pandora's initial findings, including SoundExchange's references to:

- Pandora's own documents evidencing that [redacted]. SX PFOF ¶¶ 537-541, 659-660.
- Testimony and documentary evidence from independent record company witnesses that similarly confirm [redacted]. *Id.* ¶¶ 657-658.
- Evidence from, iHeartMedia, another non-interactive service confirming that [redacted] *Id.* ¶¶ 653-657.

735. Pandora ignores all of this evidence in considering whether the Merlin license is representative of the rates that major record companies would negotiate with Pandora. This is not evidence crafted for litigation but actual information from the normal course of business and contemporaneous negotiation of the Merlin license that is further corroborated by witness testimony. The evidence SoundExchange puts forward is very much what Prof. Shapiro referred to as the "best stuff." Hr'g Tr. 2718:10-22 (May 8, 2015) (Shapiro).

c. Pandora's Litigation-Crafted Attempts To Support An Independent-Only Benchmark Fail

736. In contrast to SoundExchange's evidence based on documents created in the normal course of business, Prof. Shapiro testified that one would need to look more closely at evidence created for litigation. Hr'g Tr. 2718:10-22 (May 8, 2015) (Shapiro). Despite his admonition, Pandora relies solely on litigation-crafted evidence to attempt to show that the Merlin license is representative of what major record labels would negotiate with Pandora. Pandora makes four attempts, all of which fail.

737. *First*, Pandora cites to testimony which suggests (a) that independent sound recordings are valuable; and (b) that Merlin has experience negotiating license deals. PAN PFOF ¶¶ 146-147. As discussed *supra*, the former point asks the wrong question and, in any event, is contradicted by the substantial evidence that proves [ ]. The latter point misses the mark: This is not a question of whether Merlin is an able negotiator, it is a question of whether Merlin is a negotiator representative of major record companies. Commending the experience of Merlin or Mr. Lexton does not address whether they represent the same interests and positions as would a major record company.

738. *Second,* Pandora points to its Music Sales Experiments. PAN PFOF ¶¶ 149-151. The serious limitations and issues with those litigation-crafted experiments are discussed elsewhere, *see supra* Section II.B.3 (discussing Music Sales Experiments). Further, Pandora attempts to draw the implication that major record labels would be *more* willing to accept the rates and terms of the Merlin license because Pandora's experiments report a larger effect for major label sound recordings. Yet, despite these experiments being publically available, to date no major record label has agreed to the rates and terms that Pandora agreed to with Merlin.

739. *Third,* Pandora points to its litigation-constructed steering experiments. PAN PFOF ¶¶ 147-148, 152-157. Those experiments and their implications are discussed in detail in SoundExchange's comprehensive discussion of steering, *see* Section IV.E *infra*. Not only is the enticement of steering disproven by real-world major record company behavior, the failure to implement the Merlin deal in a timely fashion and actually provide any steering benefits, would not assist Pandora's credibility as to its promise (or threat) in negotiations, hypothetical or actual, with a major record company.

740. *Fourth*, Pandora points to Prof. Rubinfeld's analysis of interactive service licenses. PAN PFOF ¶¶ 158-163. As discussed *supra*, this is both a surprising concession to see Pandora embrace the interactive service licenses, and it does nothing to help resolve the representativeness questions because Merlin's position as a first-and-only mover with respect to Pandora differentiates this situation from the ones considered by Prof. Rubinfeld.

6. The Merlin Label Opt-Ins Are Not Representative Record Company Decisions

741. Pandora puts some focus on the number and profile of Merlin labels that have opted into the Merlin license, presumably to suggest that the opt-in levels of individual labels are indicia of the strength or representativeness of the Merlin license. PAN PFOF ¶¶ 123-126.

742. However, the election to participate in a Merlin-negotiated agreement is *not* the same as negotiating an agreement. In the former situation, the record company merely has an up-or-down election whereas in the latter, the record company has the ability to actually engage the service and negotiate for the rates and terms that it values most. In fact, there were separate independent record company witnesses—Mr. Van Arman and Mr. Barros—who provided testimony concerning their reasons for opting into the Merlin license. Their testimony plainly indicates that they put relative emphasis on different parts of the agreement. *Compare* SX PFOF

¶ 634 (Mr. Van Arman's emphasis of access to data) *with* Hr'g Tr. 6538:21-6539:13 (May 28, 2015) (Barros) (Mr. Barros's emphasis on Pre-72 as a [redacted] Record companies are not simply monolithic widget makers. Merlin labels may have had to make an up-or-down decision to participate or not in this license but that does not mean that their opt-in or opt-out decisions should be treated as a proxy for the negotiation each Merlin label would have made on its own.

743. In fact, the dynamics of Merlin's operations, where all but a handful of its members are opted-in by default and where almost all of its label count comes from the opt-in decisions of about 70 distributors (who themselves have incentives that differ materially from those of individual record companies), distort any ability to treat the Merlin label opt-ins as the equivalent of fully considered record company negotiations and/or judgments. SX PFOF ¶¶ 542-550.

744. Thus, Pandora's suggestion – expressly or by implication – that the participation of numerous Merlin labels in the agreement negotiated by Merlin is a reliable proxy for the separate negotiation of those labels lacks merit. Put another way, the Merlin license is not the reflection of how several thousand labels would negotiate if given the opportunities, it is merely the reflection of what a uniquely situated global rights agency was able to negotiate with Pandora.

7. Focusing On Representativeness Of Sound Recordings Asks The Wrong Question

745. Broadly speaking, the issue of representativeness concerns the product, i.e., the blanket license of the record companies' catalog of repertoire. To focus, as Pandora does, on whether individual independent sound recordings have the same "value" as a sound recording of a major asks the wrong question. The right question is whether the value of an independent

record company's *catalog of repertoire* is representative of the *catalog of repertoire* of a major record company.

746. Pandora's efforts to establish representativeness with respect to the product or rights at issue miss the mark. Pandora spends significant energy stating the obvious – many independent record companies release meaningful and valuable sound recordings every year. PAN PFOF 123-126.

747. This similar sound recording-specific likewise informed the Music Sales Experiments. Pandora could have constructed those experiments on a catalog-wide basis, turning off or on the full catalog of repertoire of a particular record company, but it chose not to. Rather, Pandora's data scientists expended a great deal of effort, particularly with regard to the catalog music sales experiments, trying to isolate the right list of recordings to test. *See, e.g.* Hr'g Ex. SX 133.

748. In all instances, however, Pandora did no assessment of whether the *catalogs* of repertoire offered by independent record companies were of the same value or at least of representative value to the *catalogs* of repertoire offered by major record companies. Yet there is no evidence in the record that Pandora's willingness to pay for access to the catalog of independent record companies is the same as or, at the very least, representative of Pandora's willingness to pay for access to the catalog of a major record company.

8. Regardless, The Sound Recordings Covered By Pandora-Merlin Are Not Representative

749. Pandora's attempt to show the value of the sound recordings covered by the Merlin license amounts to a brag sheet about the hits and awards earned by some of the participating Merlin labels. *See* PFOF ¶¶ 124-126. This does not prove representativeness.

750. If this spotlight list of labels reveals anything, it demonstrates the exceedingly mixed experience of Merlin labels with Pandora and their hesitance to continue to support the rates and terms reflected in the Merlin license after seeing how the agreement has performed. Two of the seven labels on Pandora's list provided witness testimony speaking strongly against the use of this license as a benchmark for the industry. Hr'g Tr. 7158:23-25 (June 2, 2015) (Van Arman); Hr'g Tr. 7109:13-7110:2 (June 1, 2015) (Wheeler). Pandora apparently has no qualms about touting the importance of these labels while at the same time contending that the Judges should afford no weight to the testimony these labels provide about the Merlin license. It is also telling that Mr. Herring had to amend his testimony because one of the very labels he originally spotlighted actually chose *not* to participate in the Merlin license.

751. Furthermore, Pandora notes that the Merlin license "covers recordings by some of the most popular and prominent artists played by Pandora, including winners of Grammys and other major record-industry awards." PAN PFOF ¶ 123. This contention, however, is betrayed by the clear evidence reflected in Pandora's business documents that [

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752. All of Pandora's efforts to highlight the importance of sound recordings covered by the Merlin analysis are qualitative and anecdotal. But they did not have to be. Pandora possesses all the data that exists about how Merlin label sound recordings were playing on Pandora's service both before and after the execution of the Merlin license. Pandora could have

done any one of an infinite number of quantitative comparisons to test, for instance, the performance of Merlin label sound recordings against non-Merlin independent sound recordings and against major label sound recordings. Pandora could have dug deep into the data to show the historical performance of Merlin label sound recordings against major label sound recordings. Pandora could have done any number of things *but chose not to* either perform such analysis or include it in the evidentiary record in this proceeding.

753. Notably, Pandora conspicuously ignores the evidence in the record about the actual percentage of Pandora performances covered by this license. Even by Pandora's own estimation, this license covers less than [ ] of Pandora performances without steering, which means Merlin labels are still only a small [ ] of Pandora's performances of independently-owned sound recordings, much less sound recordings in general. Independently-owned sound recordings comprise a roughly [ ] share of Pandora spins. Hr'g Ex. SX 269 at 73. Thus, assuming conservatively that Merlin labels comprise [ ] of Pandora performances (as Prof. Shapiro actually used the [ ] figure), Merlin labels constitute only about [ ] of the share of *independently* owned Pandora spins. Award-winning performances or not, Pandora cannot deny that the Merlin license only covers a sliver of the universe of performances on its service, much less the webcasting market in general.

754. In fact, when confronted with the artist and label royalty payments that Pandora made to the Grammy-winning Merlin label artists that Mr. Herring cited in his written rebuttal testimony, Mr. Herring made the point that [ ] Hr'g Tr. 3539:16-3540:4 (May 13, 205) (Herring). It turns out that Mr. Herring was quite right because the 2014 artist *and* label payment *combined* for the sound recordings he

described in his written testimony as "significant and critically-acclaimed sound recordings" under the Merlin license earned the following:

RESTRICTED TABLE

ARTIST	**GRAMMY AWARD**	**PANDORA 2014 ROYALTY PAYMENT TO BOTH ARTIST AND LABEL**
Aphex Twin	Best Dance/ Electronic Album	[redacted]
Erica Campbell	Best Gospel Album	[redacted]
Old Crow Medicine Show	Best Folk Album	[redacted]
The Earls Of Leicester	Best Bluegrass Album	[redacted]
Chick Corea Trio	Best Jazz Instrumental Album	[redacted]
Dianne Reeves	Best Jazz Vocal Album	[redacted]

SOURCES: Hr'g Ex. PAN 5016 ¶ 49; Hr'g Ex. SX 2250; Hr'g Tr. 3538:18-24 (May 13, 2015) (Herring)

755. The upshot is that Pandora's efforts to exclaim the Merlin label artists by award-naming falls far short of proving the license's representativeness or comparability, particularly as a Pandora's own witness has testified that critical acclaim is a poor proxy for the amount of play a sound recording might get on Pandora's service.

9. The Rights And Obligations Of The Merlin Agreement Are Not Representative Of The Statutory License

756. Without amplification, Pandora asserts that the Merlin license involves the same rights as the statutory license. *See e.g.*, PAN PFOF ¶ 88. However, SoundExchange performed a much deeper analysis of the rights and obligations covered by the Merlin license, concluding that they are *not* the same as the statutory license in many significant ways. SX PFOF ¶¶ 557-562. Some of these differences include:

- Separate waivers of the sound recording performance complement for both steering and bullets. SX PFOF ¶¶ 559-560;

- A provision allowing default Merlin preference in any rights ownership dispute. SX PFOF ¶ 562;

757. Pandora's findings do not even acknowledge these differences much less attempt to adjust for them. Given the strenuous attention by all parties on the need to adjust for differences between the rights in the target market and the rights in a proposed benchmark, it is concerning indeed that Pandora makes no effort to account for the rights differences between the Merlin license and the target market.

E. Steering Does Not Support Pandora's Rate Proposal

1. The Pandora – Merlin Agreement Cannot Be Used As A Benchmark Agreement Because Of Its [redacted]

758. Pandora relies on the Pandora–Merlin agreement and contends that the [redacted] in the agreement reflects Pandora's ability to steer. PAN PFOF ¶ 112. But the Pandora – Merlin agreement contains a [redacted] that compromises its usefulness as a benchmark agreement:

- Pandora [redacted] Hr'g Ex. PAN 5014 § 4.
- Pandora also [redacted] *Id.*

759. SoundExchange demonstrated in its Proposed Findings of Fact that the [redacted] creates a catch-22 for Pandora.

760. As a matter of simple mathematics, Pandora cannot offer [ ] to every licensee. Pandora cannot [ ][36] As Prof. Talley noted:

> [A]n affirmative obligation to steer just can't be implemented on a market-wide basis. It's just not possible for a service to say I'm going to steer listenership towards each label that I contract with.

Hr'g Tr. 6070:8–17 (May 27, 2015) (Talley).

761. Similarly, iHeartMedia's Mr. Cutler recognized that it is not possible for a webcaster to promise steering to everyone: "Certainly, the share has to–its math has to add up to a hundred, so if someone goes from 20 to 30, the rest of the pool must–those ten points must come from somewhere else." Hr'g Tr. 7239:4–8(June 2, 2015) (Cutler).

762. The Services do not contest that it is not possible for a webcaster to guarantee steering to all record labels.

763. Because the [ ] in the Pandora – Merlin agreement [ ], it cannot be a part of the statutory license. As Prof. Rubinfeld explained, "[t]he statutory license does not—and cannot—contemplate 'playment.'" Hr'g Ex. SX-29 ¶ 70 (Rubinfeld Corr. WRT). Pandora does not contest this point. Despite the fact that its benchmark agreement contains a [ ], Pandora has not included such a [ ] in its Proposed Rates and Terms.

764. Nor can Pandora escape this quandary by discarding the [ ] and retaining the [ ] from the Pandora – Merlin agreement. As SoundExchange

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[36] For example, assume that Pandora performs sound recordings from 10 labels, each of which naturally constitute 10% of Pandora's performances (for a total of 100% of Pandora's performances). [ ]

showed in its Proposed Findings of Fact, discarding the [ ] would separate the rate in the agreement from the specific bargained-for consideration that Merlin obtained in exchange for that rate.

765. SoundExchange demonstrated that [ ] have economic value to record labels. [ ]. Hr'g Ex. SX-19 at 26 (Talley WRT). [ ] Hr'g Ex. SX-29 ¶ 70 (Rubinfeld Corr. WRT). Even Prof. Shapiro recognized that [ ] have value. Hr'g Ex. PAN 5023 at 41 (Shapiro WRT).

766. In particular, the [ ] in the Pandora–Merlin agreement ensures that the agreement is, at a minimum, [ ] In other words, even putting aside all the other consideration available under the agreement, [ ]

767. In addition, the undisputed evidence shows that the [ ] in the Pandora – Merlin agreement and the [ ] headline rates are inextricably intertwined—Pandora would not have obtained the [ ] without providing the [ ]. [ ]. Hr'g Tr. 6892:15–18 (June 1, 2015) (Lexton). And during the negotiations for the Pandora – Merlin agreement, Mr. Lexton sent an e-mail to Mr. Harrison of Pandora stating: [ ]

[redacted]

Hr'g Ex. PAN 5116 at 1.

768. In response to SoundExchange's accurate claim that it is impossible to use an agreement with a [redacted] as a benchmark, Pandora repeatedly asserts that the Judges should, nonetheless, adopt the Pandora – Merlin agreement because it represents "competition."

769. For instance, to respond to SoundExchange's accurate claim that Pandora cannot [redacted] to steer to every label, Pandora quotes Prof. Shapiro's statement that: "Price competition is great for customers, at least, and I believe [the Judges] should be incorporating it under the effective competition element." PAN PFOF ¶ 187. Similarly, in response to Prof. Rubinfeld's argument that the Pandora - Merlin agreement cannot serve as a benchmark because it is an atypical agreement with a [redacted] that cannot be replicated, Pandora responds that this reflects "the forces of competition." PAN PFOF ¶ 181.

770. Respectfully, this is a slogan not a response. Pandora does not grapple with the substance of SoundExchange's argument: Pandora negotiated an agreement that exchanged a [redacted] for a [redacted]. Now, it wants the statutory license to reflect benefit of the [redacted], but it is unable to provide the bargained for consideration of the [redacted]. Because the statutory license cannot provide this bargained for consideration, the Pandora – Merlin agreement is not a useful benchmark agreement. No matter how many times Pandora uses the word "competition," it will not change this simple fact.

2. Pandora's Claim That It Can Rely On The "Threat" Of Steering Is Unfounded

771. Recognizing the serious problems inherent in relying on an agreement with [a [redacted] Pandora falls back on a second, theoretical, argument: that the threat of

steering alone would induce price competition among record companies. PAN PFOF ¶ 102. As Pandora contends: "What this argument [regarding steering commitments] wholly ignores is the powerful force that a credible *threat* of steering will have in the hypothetical market with no statutory license." *Id.* ¶ 186; *see also id.* ¶¶ 181–85, 187. As SoundExchange's Proposed Findings of Fact show, this argument has no basis in the record and, instead, is based on sheer speculation regarding what would occur in the hypothetical market. SX PFOF ¶¶ 709–47. In fact, the evidence shows that Pandora does not have a credible steering threat that would induce record companies to discount their rates. *Id.*

a. Pandora's Threat-Of-Steering Argument Is Based On Speculation Not Evidence

772. Pandora claims that the Pandora–Merlin agreements reflects Pandora's credible threat of steering and "competition" at work. PAN PFOF ¶ 117–20. But Pandora's claims regarding the threat of steering cannot logically be based on Pandora–Merlin Agreement.

773. As SoundExchange has demonstrated, there is no dispute that the Pandora – Merlin agreement contains a [redacted]. *See* Section IV.E.1, *supra*. Thus, this agreement does not support Pandora's claim that it was able to [redacted]. Indeed, the fact that Pandora was [redacted]—as opposed to a [redacted]—strongly suggests that record labels are not susceptible to this threat. If Pandora could have obtained [redacted] in the Pandora–Merlin agreement [redacted], there is no reason it would not have done so.

774. Despite Pandora's theoretical claim that the threat of steering alone will result in discounting, the record is bereft of *any* benchmark agreement that reflects this dynamic. SoundExchange's Proposed Findings of Fact demonstrate that "[t]here is not a single agreement

in the record in which a record company offered a lower price to a webcaster simply to avoid the webcaster's credible threat of steering." SX PFOF ¶¶ 699, 709–17. Rather, the benchmark agreements in the record that involve steering each involve a [ ], and do not reflect the type of "threat"-based discounting described by Prof. Shapiro. *Id.*

775. Although Pandora suggests that the Pandora–Naxos agreement involves threat-based steering, PAN PFOF ¶ 118, SoundExchange has demonstrated that the Naxos agreement had nothing to do with steering. SX PFOF ¶ 713. [

Id. at 3516:17–3517:3.

776. [

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777. The Judges should not embrace Pandora's theory in the absence of any concrete evidence that *any* (let alone *most*) willing sellers would actually discount their rates in response to a "threat" of steering.

b. Pandora's Steering Experiments Do Not Test Steering Under Real World Conditions

778. Pandora relies on its steering experiments to claim that it has a credible threat of steering. PAN PFOF ¶¶ 377–90 But the experiments do not demonstrate that Pandora would have a credible steering threat under real world conditions and in the absence of the statutory license.

779. Pandora's findings of fact discuss two sets of steering experiments—the "first" steering experiments, PAN PFOF ¶¶ 378–80, and the "second" steering experiments, *id.* ¶¶ 381–82. Although both sets of experiments suffer from the same flaws discussed below, the Judges should refuse to consider Pandora's "first" steering experiments for an additional reason. Although Pandora's witnesses briefly alluded to the *existence* of the "first" steering experiments, Hr'g Ex. PAN 5007 ¶ 22 (Herring WDT); Hr'g Ex. PAN 5020 ¶ 13 (McBride WDT), there is no testimony regarding the methodology followed, no description of the study plan, and no report of results. In fact, this is all that Dr. McBride says about the "first" experiments in his written testimony:

> Although undertaken pursuant to Professor Shapiro's direction, [the second set of steering experiments] closely match previous experiments that the Science Team ran between summer 2013 and January 2014 for business investigations in which the core music recommendation algorithms were manipulated to increase/decrease the spin share of music based on the ownership of the sound recording.

Hr'g Ex. PAN 5020 ¶ 13 (McBride WDT).

780. Because Pandora failed to provide any evidence whatsoever regarding "the study plan, the principles and methods underlying the study, all relevant assumptions, all variables considered in the analysis, the techniques of data collection, the techniques of estimation and testing, and the results of the study's actual estimates and tests" or the "facts and judgments upon

which conclusions are based," the Judges should refuse to consider the first set of steering experiments. 37 C.F.R. § 351.10(e).

781. Nor should the Judges rely on Pandora's second set of steering experiments. As SoundExchange's Proposed Findings of Fact show, both sets of Pandora's steering experiments did not approximate real-world conditions. SX PFOF ¶¶ 723–29.

782. Steering cuts against the core of Pandora's promise to its users. Professor Shapiro recognized that Pandora has "publicly touted the purity of its music selections." Hr'g Tr. 4768:20–22 (May 19, 2015) (Shapiro). Mr. Westergren, Pandora's founder, has publicly promised users that Pandora's recommendations would "be based on the genome, they will never be based on somebody buying the space." Hr'g Ex. SX-2369 at 1. In fact, Mr. Westergren recently explained that [redacted] .] *Id.* at 3.

783. Pandora failed to test the effect of widespread public awareness of steering on Pandora's public image and its relationship with its consumers. Prof. Shapiro admitted that Pandora did not test how people would react to learning "that Pandora was factoring in royalty rates and how they constructed the playlist." Hr'g Tr. 4775:4–8 (May 19, 2015) (Shapiro). He also admitted that at least some consumers would not like it if they learned that Pandora engaged in steering. *Id.* at 4774:6–16. Pandora's competitors could "fan the flames" of this discontent through comparative advertising. *Id.* at 4775:20–25, 4776:21–4777:15. Prof. Shapiro noted that he has "worried about" the question whether a competitor could use such an advertisement to "magnify" a negative reaction to steering. *Id.* at 4635:2–4636:5.

784. Because successful steering in the real world depends on consumer reactions, Pandora cannot demonstrate a credible threat of steering when consumers were completely

unaware of such steering. Pandora's failure to address the real world implications of steering is another example of how the case it has presented the Judges is fundamentally disconnected with its business realities.

c. The Only Real-World Evidence Of Steering In The Record Demonstrates That Pandora Has Been Unable To Steer

785. The only evidence in the record of Pandora's real-world ability to steer concerns its performance of the Pandora–Merlin agreement. Pandora selectively relies on this evidence to claim that it has the ability to steer. PAN PFOF ¶¶ 121–22 ("Pandora has effectively overspun the tracks of Merlin Labels."). But the evidence actually shows that Pandora's steering efforts have been an abject failure. Pandora's [redacted]. Hr'g Tr. 4676:5-16 (May 19, 2015) (Shapiro).

786. [redacted] *Id.* In fact, Pandora's February 2015 data shows that Pandora has [redacted]. Hr'g Ex. SX-2310 (native) (Tab: By Label Reporting–Feb 15). Indeed, as the chart below shows, Pandora has steered at [redacted].

RESTRICTED TABLE

[redacted]

[redacted]

Source: Hr'g Ex. SX-2310 (native) (Tab: By Label Reporting–Feb 15)

787. When confronted with Pandora's actual steering performance, Prof. Shapiro agreed that [redacted] contemplated under the Pandora – Merlin agreement. Hr'g Tr. 4677:19-23 (May 19, 2015) (Shapiro). Thus the only data in the record concerning Pandora's actual ability to steer demonstrates that it has been unable to steer toward [redacted]. Pandora's failure to address the only real world evidence regarding its ability to steer shows the disconnect between the theoretical case it has presented the Judges and the realities it faces in the marketplace.

d. Record Companies Have Strong Defenses To Pandora's Threat Of Steering

788. Moreover, through expert testimony and testimony from fact witnesses, SoundExchange demonstrated that, in a market without the statutory license, record companies would have potent defenses to any threat of steering, including refusing to license companies that threatened to steer, entering into licenses with non-discrimination clauses, or turning to other services that offer a better value proposition. SX PFOF ¶¶ 731–47. The Services have not explained how Pandora would overcome these defenses.

789. Pandora acknowledges that record labels have negotiated anti-steering clauses and MFN clauses in voluntary agreements, but claims that these provisions perpetuate a "non-competitive" market and "thwart[] competition." PAN PFOF p. 4, ¶ 80. Pandora's claim is based on sheer speculation.

790. The Supreme Court has recognized that vertical restraints—restraints imposed by a supplier on a distributor—are often pro-competitive. *See Continental T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54–57 (1977); *see also Brantley v. NBC Universal, Inc.*, 675 F.3d 1192, 1200 (9th Cir. 2012) This is true even when, as with anti-steering provisions, the restraint's "'intent and competitive impact'" is to "'limit[ ] the freedom of the retailer to dispose of the purchased products as he desire[s].'" *Brantley*, 675 F.3d at 1200 (quoting *Continental*, 433 U.S. at 60). Similarly, a number of courts that have analyzed MFNs have concluded that they are procompetitive. *See, e.g., Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995); *Ocean State Physicians Health Plan v. Blue Cross & Blue Shield of R.I.*, 883 F.2d 1101, 1109–13 (1st Cir. 1989); *Kitsap Physicians Serv. v. Wash. Dental Serv.*, 671 F. Supp. 1267 (W.D. Wash.1987); *Blue Cross & Blue Shield of Mich. v. Mich. Ass'n. of Psychotherapy Clinics*, 1980 WL 1848 (E.D. Mich. 1980).

791. Because vertical restraints may promote competition, they are analyzed under the rule of reason. *See Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 885 (2007) (rule of reason applies to vertical restraints). Applying the rule of reason requires evaluating "all of the circumstances of a case" including "specific information about the relevant business" and "the restraint's history, nature, and effect." *Id.* (citations and internal quotation marks omitted). Rule-of-reason analysis is "rigorous, requiring a detailed depiction of circumstances and the most careful weighing of alleged dangers and potential benefits." *California Dental Ass'n v. F.T.C.*, 224 F.3d 942, 947 (9th Cir. 2000) (citations and internal quotations marks omitted). In addition, such analysis must consider the "pro-competitive effects of the restraint." *Id.* (citations and internal quotations marks omitted).

792. The rule of reason must be carefully applied to avoid mistaken inferences of anti-competitive conduct. As the Supreme Court has cautioned, "mistaken inferences . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect." *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993).

793. Despite Pandora's baseless speculation, it is undisputed that no participant has offered the type of careful factual support or economic analysis required by the rule of reason. In fact, the Services' experts expressly disclaim having performed such analysis. Prof. Katz recognized that determining whether vertical restraints are anti-competitive involves "a fact-specific inquiry" that he had not performed. Hr'g Tr. 2900:7–2901:19 (May 11, 2015) (Katz). In addition, he testified that he was not offering an opinion that the anti-steering provisions at issue are anticompetitive or illegal. *Id.* Similarly, Prof. Shapiro expressly noted that he was "not making any allegations that anybody is engaged in [an] antitrust violation." Hr'g Tr. 2690:8-10 (May 8, 2015) (Shapiro).

794. Without the detailed evidence or rigorous analysis required by the rule of reason, the Services have no basis to claim that anti-steering clauses and MFN provisions are anti-competitive. Courts have recognized numerous pro-competitive justifications for vertical restraints. *See, e.g.*, *Leegin*, 551 U.S. at 882 (recognizing that vertical price restraints "can have procompetitive effects"); *Continental*, 433 U.S. at 54–57. In particular, vertical restraints, like anti-steering clauses, can promote competition between suppliers by eliminating the "free-rider" problem. *Konik v. Champlain Valley Physicians Hosp.*, 733 F.2d 1007, 1014 (2d Cir. 1984) ("[A]ntitrust analysis takes into account that some arrangements may be necessary in order to remedy . . . the so-called 'free-rider' effect.").

795. For example, consider a record company that invests significant financial resources in developing and marketing its artists. Absent an anti-discrimination clause in the license agreement between the record company and a webcaster, the webcaster could attract users to its service by touting the availability of the record company's repertoire, but subsequently steer users to a low-cost record company that invests substantially less in developing and marketing its artists. In effect, the webcaster and low-cost competitor could free-ride on the record company's investments. This free-rider effect would reduce the record company's incentive to compete in the marketplace by vigorously investing in and marketing its artists. The record company could seek to protect itself from this free-rider problem by negotiating an anti-discrimination clause in its license agreement. With an anti-discrimination clause in effect, the record company could be assured that successful investments in its artists would result in additional consumption of the record company's sound recordings. No participant has offered the evidence and analysis necessary to fairly discount these pro-competitive justifications for anti-steering clauses and MFN provisions.

e. The Major Labels Would Not Respond To Pandora's Threat Of Steering

796. Pandora claims that it has "a 'powerful' ability to steer toward and away from the repertoires of each of the Majors, just as it has done with the Merlin Labels." PAN PFOF ¶ 152; *see also id.* ¶¶ 153–57. But as SoundExchange has shown, absent a statutory license, record companies, including independent labels, would have potent defenses to Pandora's threat of steering. *See* Section IV.E.2.d, *supra*. And SoundExchange has also shown that Pandora's efforts to steer toward Merlin labels have been an abject failure. *See* Section IV.E.2.c, *supra*. In addition, the evidence shows that Pandora's ability to steer is particularly ineffective against the major labels.

797. As an initial matter, no major label has entered into an agreement with Pandora. Thus, although Pandora speculates that it could induce a major label to enter into an agreement using the threat of steering, it has not actually been able to do so. Moreover, because the major labels are must-haves for Pandora, any threat of steering by a webcaster would "be outflanked by a major's ability to threaten to withhold its entire catalog." Hr'g Ex. SX-19 at 34 (Talley WRT); *see also* SX PFOF 740–47.

798. Pandora's steering experiments confirm the must-have status of the major labels' catalogs for Pandora. During Pandora's "first set" of steering experiments, it [ ] Hr'g Ex. SX 319 at 11, 12; Hr'g Tr. 4454:9–4455:16 (May 18, 2015) (McBride). Subsequently, when Pandora tested steering again for this case, it limited its experiment to the 30% steering level. [ ] *See* Hr'g Ex. SX-29 ¶¶ 140–54 (Rubinfeld Corr. WRT). Despite the results of the first and second steering experiments, Pandora failed to test the test the impact on listening where there is a loss of 100% of a label's catalog. *See* Hr'g Ex. SX-19 at 34. Pandora's failure to run this experiment supports an inference that the major labels are, in fact, must-haves for Pandora.

F. Pandora Did Not Accurately Assess The Value Of The Merlin Agreement

799. In its Proposed Findings of Fact, SoundExchange described in detail how Pandora incorrectly valued the Merlin agreement. *See* SX PFOF ¶¶ 588-649. In particular, SoundExchange explained how:

- Pandora incorrectly valued the Merlin license because the consideration provided by Pandora was, at worst, no lower than the compensation provided under Pandora's existing statutory rates. SX PFOF ¶¶ 588-592;

- Pandora inappropriately considered only its own subjective expectations. SX PFOF ¶¶ 593-599.
- Pandora ignored key terms that provided important consideration to Merlin labels. SX PFOF ¶¶ 600-639. These terms include the Merlin license's [redacted];
- Pandora failed to account for the fact that the Merlin license also imposes significant costs on Pandora. SX PFOF ¶¶ 640-643;
- Finally, SoundExchange explained how Pandora's revenue sharing proposal is inconsistent with the Merlin license. SX PFOF ¶¶ 644-649.

800. Pandora's Proposed Findings of Fact, including its discussion of the value of the Merlin license, PAN PFOF ¶¶ 127-142, do not disturb these important facts. However, Pandora's proposed findings raise additional issues with respect to valuation of the license.

801. Pandora incorrectly suggests that the independent record company witnesses merely offered "self-serving testimony" regarding the Merlin license that should be "given little weight." PAN PFOF ¶ 142. This is true for three reasons.

802. First, SoundExchange has already explained that it is important to consider both parties' subjective expectations. SX PFOF ¶¶ 593-599. The testimony from independent record company witnesses provides important context regarding their motivations for entering the Merlin agreement and the value they saw in the agreement.

803. Second, there is nothing disingenuous or self-serving about the testimony of these witnesses. Pandora claims that Glen Barros's testimony was "disingenuous" because he testified on direct that [redacted] and later purportedly testified that he would have entered the Merlin Agreement absent these benefits. PAN PFOF ¶ 142. But Mr. Barros's testimony is not as clear cut as Pandora suggests. Instead, Mr. Barros testified that he would have to "rethink" whether he would have entered the agreement in the absence of [redacted] if the agreement

promised "more revenue." Hr'g Tr. 6538:21-6539:13 (May 28, 2015) (Barros). He agreed that "more money" under an agreement is "better than less" and that this would have influenced him towards accepting such an agreement. But he also reiterated that the other benefits had value and that that the issue of payment for pre-1972 recordings was a [ ] issue for him. Hr'g Tr. 6538:21-6539:13 (May 28, 2015) (Barros). Mr. Barros's testimony is fully consistent with the conclusion that the non-pecuniary benefits under the Merlin agreement were of significant value and should be accounted for.

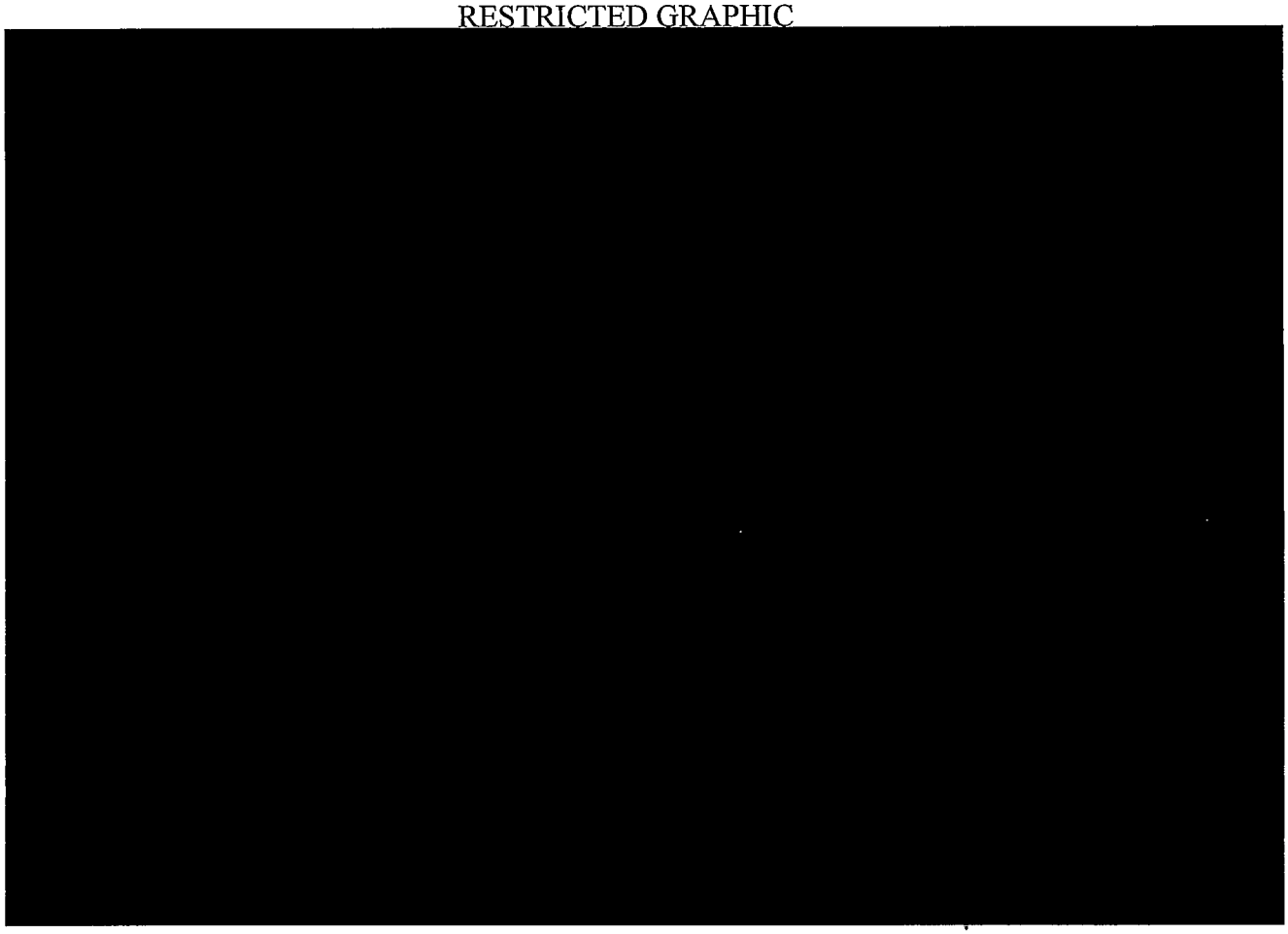
804. Without so much as mentioning their actual testimony, Pandora also attempts to besmirch the testimony of Mr. Wheeler and Mr. Van Arman as "self-serving." However, far from self-serving, their testimony is *confirmed* by actual documents in the record. For instance, when Mr. Van Arman states that access to data was important to him, his testimony is supported by the email he sent to Mr. Westergren of Pandora the day after the announcement of the Merlin license. The email stated, Hr'g Ex. PAN 5269. Similarly, Mr. Wheeler's testimony concerning the value he put on the data and marketing opportunities of the Merlin license is confirmed by the unmistakable fact that [ ]. Hr'g Tr. 7103:6-7104:16 (June 1, 2015) (Wheeler). Pandora does not deny any of this, or point to any testimony or evidence to the contrary.

805. Pandora's assertion is that the Merlin license was, at its core, just about steering. *See* PAN PFOF ¶¶ 116-122. If that was solely the value proposition, then Prof. Shapiro would

not need to concern himself with all of the other benefits that the Merlin license secured for Merlin labels. However, that stingy view of the value of the license to the Merlin labels fails to accurately assess Merlin's willingness to accept. Merlin's assessment was that [ ], Merlin labels would receive a panoply of benefits, not just steering. Hr'g Tr. 7154:4-19 (June 2, 2015) (Van Arman) ([ ]).

806. The value proposition described by Merlin and independent record company witnesses is confirmed by contemporaneous documents. First, in Pandora's original presentation, [ ]. Hr'g Ex. SX-104, at 4-5 [ ]).

RESTRICTED GRAPHIC



Hr'g Ex. SX 104 at 5.

807. Second, an internal Merlin email, cited by Pandora in its findings (PAN PFOF ¶ 119), confirms that a steering-alone value proposition was not sufficient and that Merlin labels were interested in the promotional benefits of the deal. *See* Hr'g Ex. PAN 5099 at SNDEX0316398. [redacted]

[redacted]

808. SoundExchange has previously addressed why Pandora and Prof. Shapiro's reasons for not valuing or providing a zero value to many of the Merlin provisions fail. One further point bears noting, however, given Pandora's position that there was no evidence of precise quantification on the Merlin side. The undisputed testimony in the record is that [redacted] Hr'g Tr. 7157:8-7158:2 (June 2, 2015) (Van Arman); *id.* 7163:16-20 (["[redacted] There is no evidence in the record to the contrary.

809. If a willing seller does not engage in quantification or other studies in determining its willingness to accept, then requiring such quantification is not merely harsh, it is erroneous because it will categorically understate the willingness to pay of actors who, by their testimony, do not engage in such activity in any of their licensing. On the other hand, if quantification is important enough that it is required to assess willing buyer/willing seller values, then that is a further reason to reject the Merlin license as a benchmark: The willing sellers for this one license will not be able to provide representative willingness to accept evidence because they do not engage in quantification. Either way, the one outcome that is inconsistent with the record and the testimony in this case is to pretend that the Merlin labels did not view the non-steering provisions of the Merlin license as providing any consideration.

810. Finally, Prof. Shapiro implies rates for the Merlin license based upon assumptions identified in his Appendix D, such as a [redacted] rate of non-compensable skips or an assumption

that [redacted] of total performances. Nowhere in the findings (or record) does Pandora demonstrate that those assumptions were shared with or by Merlin.[37]

811. In such a situation, it only makes sense to consider the performance data of the license, should any exist. The only performance data in the record suggests that Prof. Shapiro's assumptions are not consistent with the performance, which is admittedly limited and early given Pandora's struggles with implementation.

812. The inconsistent performance of the license can be demonstrated well on a label-by-label basis. Take, for example, Epitaph, one of the largest independent record labels and Merlin members, and one of the labels that Pandora mentions in its proposed findings. According to the only performance evidence concerning the Merlin license in the record, Epitaph's experience under the Merlin license in February 2015 is as follows:

RESTRICTED TABLE

[redacted]

[37] Certain of the services have proposed terms that would exempt performances of certain lengths, i.e., skips, from royalties. Although SoundExchange strenuously opposes these proposals, *see infra* Section X.B.1, should the Judges adopt any such proposal it would be necessary to correct for any "skip adjustment" performed in determining the rate inferred by a proposed benchmark. For example, Prof. Shapiro's skip adjustment would need to be reversed thereby *raising* the rates implied by the Merlin license well above the rates reported by Prof. Shapiro. *See* PAN PFOF ¶¶ 128-130.

[redacted]

813. Even one of the largest independent record labels, one which Pandora called out for attention in Pandora's proposed findings, [redacted].[40] Hr'g Ex. SX 2310.

814. Combining all of the Merlin labels listed in SoundExchange Exhibit 2310, yields the following result:[41]

RESTRICTED TABLE

[redacted]

[38] [redacted]

[39] 1 - ([redacted]

[40] Pandora's reporting also only covers [redacted] labels, which is inconsistent with Pandora's claim that [redacted] labels are covered by the agreement.

[41] [redacted] *See* Hr'g Ex. SX 2310.

[redacted]

815. Once again, consideration of the only performance data in the record concerning this license shows that even on an aggregate basis, Merlin labels are being played on Pandora [redacted] – and there is no evidence cited in Pandora's findings that suggests any of Prof. Shapiro's assumptions were shared with Merlin during the course of actual negotiations of the license.

G. Pandora's Attempts To Corroborate The Merlin License Are Meritless

816. Pandora makes three attempts to corroborate its rate proposal by reference to other evidence. None of those attempts has merit.

1. Naxos

817. Pandora first points to its agreement with independent genre-focused label, Naxos, as corroborative of the rates proposed by Pandora based upon the Merlin agreement. PAN PFOF ¶¶ 191. Pandora's analysis of this agreement is limited to four short paragraphs that fail to analyze the agreement, the evidence in the record related to the agreement, or the rates implied by the agreement.

818. SoundExchange has already addressed in detail why the Naxos agreement is not corroborative of Pandora's rate proposal. *See* SX PFOF ¶¶ 661, 687-696. For instance, as confirmed by Pandora's own internal correspondence, the key motivation for the Naxos agreement [redacted]

[42] [redacted]

[43] 1 - ([redacted]

[redacted] SX PFOF ¶¶ 690-692. This is the only evidence in the record concerning Naxos's motivation and, consequently, there is no evidence in the record whatsoever to suggest that Naxos agreed to the license with Pandora because of Pandora's purported ability to steer.

819. Pandora's suggestion that the Naxos deal was somehow motivated by the [redacted] as well as the absence of any evidence regarding Naxos's interest in steering. PAN PFOF ¶¶ 191-192. [redacted] SX PFOF ¶¶ 690-692.

820. Pandora's calculation of effective rates under the Naxos license is also extremely dubious. Its proposed findings cites to a portion of Prof. Shapiro's written rebuttal testimony that asserts different effective rates corresponding to ad-supported, subscription, and blended performances and depending on the level of steering. PAN PFOF ¶¶ 193-194. But the license itself does not distinguish [redacted]. *See* Hr'g Ex. PAN 5018 at 3-4. If Prof. Shapiro did, as reported, apply "the same approach to Pandora's agreement with Naxos" that he used for Pandora's agreement with the Merlin labels without accounting for the clear differences between the royalty rates and terms between the agreements, this would be clear error. *See* Hr'g Ex. PAN 5023 at 37-38 (Shapiro WRT).

821. Regardless, the ultimate issue is that there is a dearth of evidence in the record on this point. Pandora did not cite to any explanation for the Naxos calculations nor did Prof. Shapiro provide those calculations in his rebuttal report. *See* SX PFOF ¶ 687. Thus, his

assertion of effective rates, unsupported by his actual calculations and inconsistent with the actual terms of the Naxos license, should be afforded no weight.

822. Pandora also overlooks inconsistencies with respect to the actual terms of the Naxos license, not the least of which is that [.] SX PFOF ¶¶ 661, 679 ([ ]). Thus, it is unclear how the license actually corroborates Pandora's rate proposal.

823. Finally, the Naxos agreement should be accorded no weight because Naxos is unquestionably unrepresentative of most willing sellers. Naxos is a genre-specific classical music label that, according to Mr. Herring, has a [ ] SX PFOF ¶¶ 690-692. Its repertoire comprises a tiny sliver of genre-specific performances on Pandora. SX PFOF ¶¶ 694-695. Thus, a license between it and the behemoth of webcasting – [ ] (*see* SX PFOF ¶ 661) – cannot be treated as representative of the rates that most willing buyers would agree to with most willing sellers.

2. iHeartMedia Agreements

824. Pandora also claims that the licenses offered by iHeartMedia "reflect the emergence of competition in the non-interactive webcasting market." *See* PAN PFOF ¶¶ 93-94. Pandora, however, conducted no analysis whatsoever of these agreements, their negotiation, or whether they, in fact, reflect competition.

825. Prof. Shapiro confirmed that he did not himself analyze the iHeart-Warner deal but just cited the numbers identified by Profs. Fischel and Lichtman. Hr'g Tr. 2673:24-2674:3 (May 8, 2015) (Shapiro). In response to a question from the Judges, Prof. Shapiro further

admitted that he did no independent check on the work of Profs. Fischel and Lichtman at all, noting that he did not do his own analysis of that agreement. Hr'g Tr. 2674:7-2675:11 (May 8, 2015) (Shapiro).

826. It is therefore unsurprising that Pandora chose to "leave [the] detailed discussion of iHeartMedia's agreements to that litigant," PAN PFOF ¶ 94, as it has no analysis whatsoever to offer concerning those agreements. SoundExchange's own detailed analysis of the iHeart agreements is provided in Sections V.A & V.B, *infra*.

3. SDARS II

827. Pandora also suggests that the Judges' decision in the *SDARS II* proceeding, should serve to corroborate the Merlin license, even though the decision is exactly that – a regulatory decision, not a market license, made under a different statutory regime concerning a different statutory license with a different willing buyer. *See* PAN PFOF ¶¶ 195-205; SX PFOF ¶¶ 886-896 (discussing differences between satellite radio and webcasting market). Despite these obvious and inescapable differences, Pandora devotes only one paragraph to explain the comparability of the *SDARS II* decision. *See* PAN PFOF ¶ 196.

828. Because the *SDARS II* decision is referred to by multiple services, SoundExchange's detailed discussion of that decision is at *infra* Section VIII.

H. Pandora's Critique Of Professor Talley's Testimony Misconstrues His Testimony And Is Incorrect

829. Pandora attempts to downplay Prof. Talley's critique of the Pandora-Merlin agreement. Pandora's arguments fail in this regard.

830. As Prof. Talley testified, the imposition of a statutory license can crowd out a significant number of consensually negotiated transactions that would otherwise exist above or near the statutory rate. Hr'g Ex. SX-19 at 48-60 (Talley WRT); Hr'g Tr. 6021:25-6030:4,

6034:4-6037:19 (May 27, 2015) (Talley). Because the Pandora-Merlin agreement exists at the far left-hand tail of the distribution curve of potential rates that would exist in the absence of a statutory rate, it therefore reveals a rate that both suffers from selection bias and a downward bias created by the Pureplay rates. Hr'g Ex. SX-19 at 54-56 (Talley WRT); Hr'g Tr. 6034:4-6037:19 (May 27, 2015) (Talley). By contrast, the interactive service agreements avoid this problem because they do not exist in the direct shadow of the statutory license. *See* Hr'g Tr. 6036:15-6037:15 (May 27, 2015) (Talley).

831. Prof. Talley's structural modeling approach revealed that, due to the effect of the statutory shadow, the Pandora – Merlin rates could skew significantly further from the true willing buyer/willing seller rate than the interactive benchmark. This is true even where Prof. Talley stacked the deck against the interactive benchmark by assuming (i) that sellers in the interactive space have undue bargaining power, (ii) sellers in the non-interactive space have less bargaining power, and (iii) bargaining power was equally distributed in the Pandora-Merlin deal. *See* Hr'g Ex. SX-19 at 57-58 (Talley WRT).

832. Pandora argues that his analysis does not apply to the Pandora-Merlin agreement because Prof. Talley states that the statutory license crowds out deals to the exclusion of those remaining direct deals "involving relatively low-value buyers and sellers," and that the Pandora-Merlin deal does not fall within that category. Pandora PFOF ¶¶ 188-189 (discussing Hr'g Ex. SX-19 at 28-29, 47, 53 (Talley WRT)). This argument, which misconstrues Prof. Talley's testimony, is without merit.

833. As Prof. Talley explained at the hearing:

> Even though it's clear Pandora is a very large player in the noninteractive space, the thing that one is negotiating over matters as well. In this case it wasn't the catalog of a major label. It was Merlin. And there was, as I understand it, even options for the

> various parts of Merlin to decide to go into that deal or not. So it was a much smaller player within Pandora's overall portfolio of songs. So it could well be the case that Pandora is a high-value company but just doesn't value this particular bundle of assets very highly.

Hr'g Tr. 6038:9-21 (May 27, 2015) (Talley).

834. Moreover, Pandora ignores that Merlin valued the deal at or above the statutory rate. *See supra* Section IV.F. So, even if the Pandora-Merlin deal is not below the statutory rate, then it is essentially at or above the statutory rate, again reflecting the power of the statutory shadow.

V. IHEART'S RATE PROPOSAL AND SUPPORTING EVIDENCE DO NOT REFLECT THE RATES AND TERMS THAT WOULD BE NEGOTIATED BY WILLING BUYERS AND SELLERS ABSENT THE STATUTORY LICENSE

835. Undeterred by evidence, logic, or common sense, iHeart continues to argue for an absurd rate of $0.0005 per performance for custom and simulcast offerings. Prof. Fischel was right to be "concerned whether the proposal that [he and Prof. Lichtman] were advancing would be credible." Hr'g Tr. 5314:14-15 (May 21, 2015) (Fischel). iHeart's proposal strained credulity when made, and the record evidence did nothing to advance iHeart's cause. The same is true for iHeart's Proposed Findings of Fact, which elide all of the ways that iHeart's proposal was shown to be specious.

836. Section A responds to iHeart's stubborn defense of Profs. Fischel/Lichtman's "incremental" approach. That approach assumes that the purported "incremental" or "second bundle" rate applies to *all* performances. It simultaneously ignores that a "market share uplift" agreement *only* happens in the shadow of the statutory license—and that Profs. Fischel/Lichtman's approach does not in fact "cure" the problem of the statutory license shadow.

837. Section B explains the correct method for analyzing the benchmark agreements—the average effective rate analysis. The average effective rate can be calculated by looking at the

buyer's expectations for the consideration it would pay; the seller's expectations for the consideration it would receive; and the actual performance under the agreement. The Judges should use the full panoply of available information—including how the agreement actually performed—to determine whether, and if so, how (and which of) the parties' projections more accurately reflects the market.

838. Section C discusses the iHeart-Independent and Pandora-Merlin agreements and why the incremental analysis is equally flawed when applied to those agreements (even more so in application) and cannot confirm iHeart's rate proposal or the incremental approach.

839. Finally, Section D responds to iHeart's additional evidence—Profs. Fischel/Lichtman's "Thought Experiment" and EVA Analysis—both of which are irrelevant from a statutory perspective and provide no useful information regarding the rates to which willing buyers and willing sellers would agree. iHeart's analysis of the SDARS II statutory rates is discussed in Section VIII, *infra.*

A. iHeart's "Incremental" Analysis Of The iHeart-Warner Agreement Is Wrong Conceptually And As A Matter Of Fact

1. Profs. Fischel/Lichtman's "Incremental" Analysis Fails Conceptually To Provide Any Helpful Information As To The Rates And Terms To Which Willing Buyers And Willing Sellers Would Agree Absent A Statutory License

840. iHeart stands by Profs. Fischel/Lichtman's methodology for analyzing iHeart's and Pandora's proposed benchmark agreements. *See generally* IHM PFOF § III (¶¶ 168-234). The incremental approach is not an economically sound or useful methodology for determining the rates to which willing buyers and sellers would agree—the average effective rate approach is the proper method of analysis. SX PFOF § IX.B.2 (¶¶ 770-78); *see* Section V.B *infra* discussing the average effective rate analysis of the iHeart-Warner agreement. Moreover, the incremental approach does not incorporate the section 114(f)(2)(B) factors, and cannot escape the shadow of

the statutory license, the single reason Profs. Fischel/Lichtman give for why it is a superior approach.

841. Notably, the incremental approach is not a methodology endorsed by the academically trained economists testifying in this proceeding—Prof. Shapiro applies the *average effective rate* methodology as does Prof. Rubinfeld; and, to the extent Prof. Katz analyzes potential benchmark agreements, he does too. Similarly, the incremental approach has no basis in economic literature, case law addressing the subject of valuation, or any other scientific endorsement that would lend it credibility. To the contrary, as Prof. Fischel candidly admitted, he and Prof. Lichtman "came up with [the incremental approach]" specifically for these proceedings. Hr'g Tr. 5316:19-20 (May 21, 2015) (Fischel).

842. At the hearing, Prof. Fischel was confronted with an example that proves the absurdity of the incremental approach—a buy-one-get-one free or discounted offer (aka "BOGO").[44] Prof. Fischel *agreed* that in the BOGO example no one would say that free (or the discount) was the correct rate and that an *average rate* would be the correct approach: "If it were, let's say, a typical promotion that you see all the time if you buy one, you get one free, ***nobody would say that free is the correct rate. You would want to average the two.***" Hr'g Tr. 5366:13-17 (May 21, 2015) (Fischel) (emphasis added).

843. Moreover, the "incremental" rate simply does not represent a true *market* rate, where the incremental approach is applied to transactions in a market with a compulsory license:

> JUDGE STRICKLER: A question for you. Let's take a slight variation on the ice cream cone analogy. Let's say the government sets a price for an ice cream cone. If you want to buy one ice cream cone at a dollar. If you want an ice cream cone with the ice

[44] Prof. Rubinfeld also criticized Profs. Fischel/Lichtman's methodology using the "BOGO" example in his written rebuttal testimony. Hr'g Ex. SX-29 ¶ 24 (Rubinfeld Corr. WRT).

cream in it, it's a buck. But if you buy another one, you can, you know, you can get them both for $1.05. Under your analysis, would you say that the ***market price for an ice cream cone is five cents***?

THE WITNESS: In your example, do you get the second in a negotiated transaction?

JUDGE STRICKLER: Yes, the vendor says it's a dollar. The government says you want this one ice cream cone, you've got to give me a dollar. He says, I want two ice cream cones. The vendor says, well, for two of them, I'll take $1.05. Are you saying that reflects a ***market price of a[n] ice cream cone of five cents***?

THE WITNESS: I think it might depend. You might want to know a little bit more information. But for sure in that example, if what you were trying to determine is whether – is what the market price for ice cream cones would be in the absence of whatever the government regulation is that's forcing you to pay a dollar, you wouldn't consider the first part of the transaction, the first ice cream cone for a dollar because that's the same circularity problem that I mentioned before, ***so you would dismiss that.***

JUDGE STRICKLER: So if I'm some horrible central planner and I look at costs – we've seen those in history. I say, no, a dollar makes sense as the right price, but really given the costs of creating an ice cream cone don't support a dollar. It should be something different, it's 30 cents, 40 cents, whatever. The ice cream manufacturers have a – they've been able to capture it, the government, so to speak, so they ask for a dollar. Then in the negotiations you find out you can get a dollar – for $1.05 you can get two ice cream cones. Because the government – the central planner has messed up and set a price of a dollar, for purposes of determining the market price, ***are you saying we should not only disregard the central planner but assign a value of zero instead***?

THE WITNESS: Well, at least with respect to the first part, if – it depends on what your objective is. If your objective is to come up with the price of ice cream cones in the absence of what the central planner dictated, which is somewhat analogous to this proceeding, then I think, at least my understanding of this proceeding, then you would disregard what the central planner decreed because the whole purpose of the exercise is to figure out what the price of ice cream cones would be between willing buyers and willing sellers in the absence of the central planner.

Hr'g Tr. 5367:13-5369:22 (May 21, 2015) (Fischel). In short, Prof. Fischel balked when it became clear that his methodology would require assigning a price of zero to the "incremental" product. But that is essentially what he and Prof. Lichtman did in their analysis. The Professors simply ignore all performances but those "incremental" ones; they thereby assume away the vast majority of performances. This assumption, however, has no economic justification and no factual basis in any market transaction. The purported "incremental" performances would not exist *but for* the assumed statutory ones and would not be discounted *but for* the overall increase in the royalties paid to the seller.

844. The core economic error is to assume that the purported "market price" for the "second bundle" of performances applies to *all* performances. One simply cannot assume that the market price for *all* performances would be the same as the purported "second bundle"; just as one would not (and should not) assume that the market price for both items in a buy-one-get-one-free is zero, or that both ice cream cones would be five cents in the example discussed between Prof. Fischel and Judge Strickler, quoted above. In other words, the logic of the incremental approach (which is really just a measure of the volume discounts) fails when Profs. Fischel/Lichtman attempt to take the "rate" they derive for the purported "incremental" performances and claim that the parties would have agreed to that same rate for *all* performances. The *average effective rate* approach, not the incremental approach, is the proper analytical method because only it accounts for all licensed performances. (This methodology is explained and applied more fully in Section V.B, *infra* and in SoundExchange's Proposed Findings of Facts, Section IX.C (¶¶ 795-858).)

845. Moreover, contrary to iHeart's assertions and despite iHeart's protestations to the contrary, IHM PFF ¶ 169, the incremental methodology does not incorporate § 114(f)(2)(B)'s

"economic, competitive, and programming" considerations such as "whether use of the service may substitute for or may promote the sales of phonorecords or otherwise may interfere with or may enhance the sound recording copyright owner's other streams of revenue from its sound recordings" and "the relative roles of the copyright owner and the transmitting entity in the copyrighted work and the service made available to the public with respect to relative creative contribution, technological contribution, capital investment, cost, and risk." 17 U.S.C. § 114(f)(2)(B).

846. iHeart is correct that the *agreements* (as with the other proposed benchmark agreements) incorporate those particular parties' "'economic, competitive, and programming' concerns, including their assessment of the promotional value of non-interactive webcasting on the labels' other sources of revenue and their relative creative and technological contributions. " IHM PFOF ¶ 169. However, iHeart is wrong to assume, without justification, that the incremental approach which by definition analyzes only a small portion of the performances and revenue covered by the agreement would "fully and necessarily incorporate the parties' [view of the factors included in section 114(f)(2)(B)]." *See* id.

847. Profs. Fischel/Lichtman give no explanation as to why an "incremental" analysis of those agreements arriving at an "incremental" rate would *fully* account for the § 114(f)(B)(2) considerations. Those considerations are incorporated within the *total* agreement because they apply to the *entirety* of a service or license, and Profs. Fischel/Lichtman deliberately ignore the largest portion of the performances and royalties covered by the agreement in favor of analyzing only that "portion of each direct deal that was not controlled by the statutory rate." IHM PFOF ¶ 172. This stands in contrast to the average effective rate that reflects the rate agreed to for the entire license, which would, in turn, reflect those particular parties' assessment of the

promotional or substitutional impact of the service as well as each parties relative contributions.[45]

848. Profs. Fischel/Lichtman justify the purported "incremental" approach because the average effective rates—*for direct licenses for non-interactive streaming*—are greatly influenced by the statutory rates (or the rates paid under a relevant statutory settlement). On this point, the experts agree. *See* Hr'g Ex. IHM 3034 ¶¶ 45-49 (Fischel/Lichtman AWDT); Hr'g Ex. SX-17 ¶ 184 (Rubinfeld Corr. WDT). The experts disagree on the proper method of addressing the "shadow." As Prof. Rubinfeld explains, the average effective rate analysis is the proper methodology, but it must be applied to direct license agreements that are not so heavily influenced by the statutory license—agreements with interactive streaming services. Hr'g Ex. SX-17 ¶ 158 (Rubinfeld Corr. WDT); *see also* Hr'g Tr. 4141:17-18 (May 15, 2015) (Lichtman) (Prof. Lichtman agreeing that the shadow "probably weighs less" on the interactive services benchmarks).

849. Profs. Fischel/Lichtman rely on the incremental approach to "escape" the shadow. As iHeart implicitly admits, the incremental approach necessarily results in a rate lower than the agreement rates. IHM PFOF ¶ 171. iHeart justifies this assumption through arguing (and

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[45] As explained in SoundExchange's Proposed Findings of Fact, Section XIII.B (¶¶ 1097-104), the extent to which the iHeart-Warner and iHeart-Independent agreements reflect the section 114(f)(B)(2) factors cannot viewed using the Judges' traditional presumption that directly negotiated agreements take account of parties' assessments of promotion and substitution and relative contribution. This is because these single, first-in-time agreements do not necessarily represent the market's (as compared to one party's) view of the promotional/substitutional impact of these services or the relative contribution of the service to the consumer. For example, while Warner clearly valued [ ] because it would not have agreed to the rates it did without that consideration (Hr'g Tr. 7416:4-16 (June 3, 2015) (Wilcox)), UMG [ ] (Hr'g Tr. 7227:15-23 (June 2, 2015) (Harrison)).

mischaracterizing SoundExchange's economist's testimony[46]) that the current statutory rates are necessarily too high and asking the one-sided question of "how low those rates *would have been* –if the statutory rate did not act as a default and a starting point for negotiation." *Id.* However, no reason exists to assume that *absent the statutory license* the direct non-interactive licenses necessarily result in rates *lower* than the statutory rates.

850. As Prof. Talley explained, the effect of the statutory license is actually to crowd out negotiated agreements near or above the statutory rates resulting in the few direct licenses for statutory services that we see here—Pandora-Merlin, iHeart-Warner, and the iHeart-Independent agreements—which would not be licensed at the headline rates were there no statutory license. Hr'g Ex. SX-19 at 48-60 (Talley WRT); Hr'g Tr. 6021:25-6030:4, 6034:4-6037:19 (May 27, 2015) (Talley). iHeart's approach nonetheless assumes a lower rate and is therefore biased toward finding one *even if* iHeart had reasons—whether related to the terrestrial performance right or precedent for these proceedings to agree to a higher effective rate if it believed the agreement could be used as a benchmark to lower the statutory rates going forward. *See* SX PFOF ¶ 842 (describing iHeart's motivations for the agreement as potentially including [redacted] (citing Hr'g Tr. 2353:17-25 (May 7, 2015) (Wilcox);

[46] iHeart mischaracterizes Prof. Rubinfeld's testimony regarding whether the current statutory rates are above market rates—they are not. Prof. Rubinfeld testifies "Because we do not see widespread renegotiation of the statutory rate, one can infer (other things being the same) that the rate is not too high; rather it is an appropriate market rate or it is too low." Hr'g Ex. SX-17 ¶ 90 (Rubinfeld Corr. WDT); *see also id.* ¶ 166 ("the general absence of evidence of directly licensed agreements between the major record companies and webcasters for non-interactive services (most non-interactive services make use of the statutory license rather than enter into direct negotiations), leads one to infer that the existing statutory rates are likely below the level which would maximize the joint profits of licensees and licensors."). A single Pandora license and a small group of iHeart licenses both covering much less than a quarter of the market do not represent widespread renegotiation of the statutory rates.

Hr'g Tr. 7354:16-7355:14 (June 2, 2015) (Cutler)). iHeart further makes unsubstantiated statements that lower rates benefit the *record labels.* This claim assumes (1) that directly negotiated agreements result in lower rates, when as an effective matter, they may actually be higher due to the value of in-kind consideration to the label; and (2) that the record label has no opportunity cost in terms of users and listening hours. *See* IHM PFOF ¶ 170.

851. Additionally, as explained in SoundExchange's Proposed Findings, even the incremental methodology is influenced by the statutory license because iHeart [redacted]. SX PFOF (¶¶ 764-65). As Mr. Cutler wrote in an internal email: [redacted] H'rg. Ex. SX-1109; *see also* Hr'g Tr. 7354:16-7355:14 (June 2, 2015) (Cutler) [redacted]); Hr'g Tr. 4056:15-19 (May 15, 2015) (Lichtman) (describing "the worry that the deals were designed to influence this hearing").

852. The iHeart-Warner and iHeart-Independent agreements are further influenced by the statutory license because the recorded music companies had no ability to deny iHeart the right to perform its repertoire. Hr'g Ex. SX-17 ¶ 186(a) (Rubinfeld Corr. WDT). In other words, the ability to walk away—the hallmark of a market transaction free from compulsion—was absent in each of these agreements, giving iHeart leverage that it would not have in the open market. As a result, the iHeart agreements are crafted not as a "win-win" but in a manner that provides incentives to only those rights owners who signed up for direct deals at the expense of

those rights owners who did not. Hr'g Tr. 2374:4-22 (May 7, 2015) (Wilcox). Not only would it [redacted] (Hr'g Ex. SX-17 ¶ 183 (Rubinfeld Corr. WDT); Hr'g Tr. 7239:4-16 (June 2, 2015) (Cutler)), but attempting such a licensing strategy in the open market would be rebuffed by rights owners. *See* Section IV.E *supra* (regarding steering). In any event, the availability of the statutory license enabled iHeart to negotiate the iHeart-Warner agreement without compromising iHeart's ability to perform the sound recordings of other recorded music companies, including most notably the sound recordings of Sony and Universal.

853. Because the incremental analysis does not escape the shadow of the statutory license, as Profs. Fischel/Lichtman acknowledge, the iHeart-Warner and iHeart-Independent agreements (like the Pandora-Merlin agreement) cannot be relied upon as primary benchmarks. iHeart admits that the agreement cannot be replicated across the industry. IHM PFOF ¶ 203. iHeart's only answer as to why it should nonetheless be a benchmark in this proceeding (despite the fact that steering agreements cannot be universalized as market agreements because the same price and performances cannot be granted to every copyright owner) is to say that the "steering price" is nonetheless a market price because a *single* buyer and *single* seller agreed to it. IHM PFOF ¶ 204. This misses the point.

854. The task at hand is to determine the rates for the entire industry. Setting rates at a low first-mover rate—and failing to account for the consideration over and above the stated rate that the buyer provides the seller as part of the first-mover advantage—would be wrong as a matter of law under the statute. The iHeart approach fails to acknowledge that other sellers would not agree to such a low rate because they cannot receive the additional consideration that induced the first mover to accept the stated rate; nor would those other sellers have to agree to

such a low rate, because iHeart would not have the statutory license to fall back on. iHeart offers no rationale and no adjustment to its rate proposal for the industry. Without such adjustments, the steering rate (or incremental rate) cannot be extrapolated and applied to other copyright owners, particularly because the statutory license cannot guarantee a particular market share or additional performances.

2. No Party Other Than iHeart Endorsed Profs. Fischel/Lichtman's "Incremental" Approach

855. iHeart argues that the parties to the iHeart-Warner, iHeart-Independent, and Pandora-Merlin agreements "took as a given the current number of performances under the statutory license and the statutory rate, and negotiated over the incremental benefits of additional plays." IHM PFOF ¶ 171. Yet, this is not how the actual witnesses who negotiated the agreements, or Prof. Shapiro[47] and Prof. Rubinfeld who analyzed them, viewed these agreements. They each analyzed the agreements *as a whole* including the additional benefits (or cost savings) to both sides, which created value to the record labels beyond that granted by the statutory license.

856. None of the academically trained economists in this proceeding endorse Profs. Fischel/Lichtman's incremental analysis. Prof. Shapiro cites Profs. Fischel/Lichtman's report for the *average* effective rate—[ ]—which, as described in subsection V.B *infra*, is the proper method for analyzing potential benchmark agreements. Hr'g Ex. PAN 5023 at 38 (Shapiro WRT). Although NAB cites the rates that Profs. Fischel/Lichtman

[47] Although SoundExchange agrees with Prof. Shapiro's approach at a very high level—that the one should look at the average effective rate—it disagrees with his application of that approach on a number of levels, including accepting the rates of the iHeart-Warner and iHeart-Independent agreements as calculated by Profs. Fischel/Lichtman without addressing all of the value received by the record labels.

derive from the iHeart-Warner agreement as supportive of NAB's proposal, Prof. Katz himself never endorsed the approach.

857. None of the fact witnesses testified to analyzing any of the 29 direct licenses using the "incremental" methodology or anticipating an effective rate from those agreements at or near $0.0005 per performance. As Prof. Fischel admitted:

- *No* communications between iHeart and Warner reference directly or indirectly an effective, marginal, or "incremental" rate of $0.0005 under the iHeart-Warner agreement. Hr'g Tr. 5490:1-4 (May 22, 2015) (Fischel).
- *No* internal iHeart documents reference an expected rate of $0.0005 for the iHeart-Warner agreement. Hr'g Tr. 5490:5-7 (May 22, 2015) (Fischel).
- *No* documents or testimony show that any parties—least of all Warner and iHeart—ever had a "meeting of the minds" as to a rate of $0.0005 per performance. Hr'g Tr. 5489:19-25 (May 22, 2015) (Fischel); *see also* Hr'g Ex. SX-29 ¶ 23 (Rubinfeld Corr. WRT).
- In fact, none of the iHeart agreements—or any other agreement submitted by any other party—has $0.0005 as the stated per-performance rate or within any range of stated rates. *See generally* Hr'g Exs. SX-33 (iHeart-Warner Agreement); IHM 3340, 3342-43; 3345; 3347; 3349; 3351-70 (iHeart-Independent Agreements); PAN 5014 (Pandora-Merlin Agreement); SX-114 (Beggars Benchmark Agreements); SX-109 (Merlin Benchmark Agreements); SX-80 (Sony Benchmark Agreements); SX-87 (UMG Benchmark Agreements); SX-100 (Warner Benchmark Agreements).

858. Ron Wilcox explained that Warner did not view the agreement as constituting two distinct "bundles" of performances and consideration— that was not how the agreement was negotiated between Warner and iHeart, and that is not how the ultimate agreement is structured. In Mr. Wilcox's words:

> Fischel-Lichtman have not accurately analyzed the agreement that Warner and iHeart executed or our negotiations with iHeart. Warner and iHeart never discussed a license using the "bundles" construct used in the Fischel-Lichtman analysis. Warner did not model the agreement under that construct; and most importantly, the agreement does not embody any such construct.

Hr'g Ex. SX-32 ¶ 4 (Wilcox WRT). Indeed, iHeart cites no fact witnesses—not Mr. Glen Barros, Mr. Bob Pittman, Mr. Steven Cutler, no one—who testified that the Fischel-Lichtman analysis, arriving at a rate of $0.0005, accurately reflected their assessment of the expected rates under the iHeart agreements or their view of the market rates for non-interactive streams overall. *See, e.g.* Hr'g Tr. 4805:18-4806:2 (May 20, 2015) (Pittman) ([redacted])

859. Moreover, the parties' projections do not employ the incremental approach. The iHeart [redacted] projection that Profs. Fischel/Lichtman rely upon does not calculate the incremental rate. *See* Hr'g Ex. SX-221. Likewise, Mr. Wilcox attached nearly 20 pages of models and projections to his testimony to illustrate that Warner did not conduct an "incremental analysis" of the iHeart-Warner agreement. Hr'g Exs. SX-91 and SX-92. iHeart focuses on one page of one model and dubs it "Warner Expectations Spreadsheet," a clever name that was not given to that document anywhere in evidence or otherwise. *See* IHM PFOF ¶ 191. Neither the particular page of the exhibit that Profs. Fischel/Lichtman reference, nor any of the other projections that Warner conducted reflect the "incremental" approach or calculations. Indeed, none of the documents, aside from those created by Profs. Fischel/Lichtman analyze the agreements using the purported incremental methodology or support that approach.

860. Finally, the iHeart-Warner agreement provides no reasonable method of determining what constitutes a "first" as compared to a "second" bundle of performances. iHeart asserts that the parties to the agreement took the performances that would have happened under the statutory license "as a given" (IHM PFOF ¶ 171, 173) —but the myriad cases that iHeart alone studied to try to estimate the number of performances proves this false. The iHeart-

Warner agreement is a single license for *all* performances pursuant to that agreement. To the extent that the agreement has two distinct "bundles" at all, they are between simulcast and non-simulcast performances. The simulcast performances [ ]. Hr'g Ex. SX-33 at 14, § 3(a). Non-simulcast performances [ ]. Hr'g Ex. SX-33 at 15-16, § 3(b)(i)-(ii). That iHeart viewed the agreement as incentivizing it to perform more Warner sound recordings does not mean that the agreement created a separate license for incremental performances of Warner sound recordings.

3. Profs. Fischel/Lichtman's Incremental Analysis Is Further Flawed As Executed

861. Even if Profs. Fischel/Lichtman's "incremental" approach has some value as a method of analyzing the iHeart-Warner and other agreements, Prof. Fischel/Lichtman's application of that methodology is riddled with errors and therefore unreliable. These errors are described in detail in SoundExchange's Proposed Findings of Fact. SX PFOF § IX.B.3-5. Correcting these errors demonstrates that even under the incremental approach, the iHeart-Warner agreement supports SoundExchange's rate proposal.

862. *First*, Profs. Fischel/Lichtman wrongly rely on a single iHeart projection—[ ]—rather than accounting for the range of projections that iHeart believed possible. Hr'g Ex. IHM 3034 ¶ 40 (Fischel/Lichtman AWDT); *see* discussion SX PFOF

§ IX.B.3 and B.5. Mr. Cutler's own written testimony explains that an entire "set of projections" was shared with their Board of Directors. Hr'g Ex. IHM 3338 ¶ 9 (Cutler WDT); *see also* Hr'g Tr. 7263:25-7264:3 (June 2, 2015) (Cutler). The Board reviewed and considered at least three scenarios [ ], and entered into the agreement with Warner having accepted each of those cases as possible. Prof. Fischel candidly admitted to analyzing each of the projections and acknowledge that some [ ]. Hr'g Tr. 5365:11-12 (May 21, 2015) (Fischel). Profs. Fischel/Lichtman cannot reasonably justify reporting only an analysis based on a single projection rather than the range that iHeart considered possible and accepted when it entered into the agreement.

863. Profs. Fischel/Lichtman nonetheless decided to *ignore* the range of expectations—including those proving iHeart expected to pay rates significantly in excess of the $0.0005 that Profs. Fischel/Lichtman ultimately derive. Profs. Fischel/Lichtman nonetheless opt for relying on the single projection which, manipulated through Profs. Fischel/Lichtman's incremental formula, results in a purported "incremental" rate of $0.0005. *See* Hr'g Tr. 5365:9-24 (May 21, 2015) (Fischel) (justifying [ ]); *see also* Hr'g Ex. IHM 3034 ¶ 40, n.42 (Fischel/Lichtman AWDT). They do so despite ample evidence that the [ ] projection was, in fact, overly optimistic and not reflective of reality. Hr'g Tr. 7264:22-7265:1 (June 2, 2015) (Cutler).

864. iHeart's Proposed Findings of Fact offer a new rationale for relying on the[ ] case: it [ ]. IHM PFOF ¶ 183. Not so. iHeart's unsupported statement that iHeart and

Warner were purportedly on the same page with their assumptions regarding performance of the agreement is belied by the evidence.[48] No witness—not from Warner and nor from iHeart—testified that the parties were in agreement on the most reasonable assumptions. Accordingly, the documents make clear that there was disagreement and possibly "puffery" assumptions shared between the parties. For example, the document that iHeart dubs the "Warner Expectations Spreadsheet," [ ]. Hr'g Ex. SX-32 ¶ 15 (Wilcox WRT) ([ ]). This differs in material respects from the iHeart [ ] case assumptions for total listening hours. The [ ] case projects average monthly performances at [ ] (Hr'g Ex. SX-221) whereas the Warner spreadsheet that Prof. Fischel relies upon shows [ ] (Hr'g Ex. SX-92 at 15 ([ ])). Additionally, documents reveal that iHeart was providing different assumptions to Warner than it was using internally to influence Warner's decision-making process. *See* Hr'g Ex. SX-1042 [ ]

865. As explained more fully in SoundExchange's Proposed Findings of Fact, had Profs. Fischel/Lichtman reported the results of applying their "incremental" methodology to other iHeart projections with more realistic growth assumptions, including the [ ] case,

[48] iHeart's mischaracterization of the evidence aims to make up for the fact that its rate proposal and Profs. Fischel/Lichtman's analysis relies on *one side's projections*—not both and certainly not shared projections between the two. *See* SX Reply COL Section III.B.

they would have reported higher "incremental rates"—$0.0021 per incremental performance. SX PFOF ¶ 793.

866. *Second*, iHeart reiterates in its Proposed Findings of Fact, as Profs. Fischel/Lichtman wrongly claimed in their written testimony, that the [redacted], without any rationale or explanation (nor is there one anywhere in the documents) justifying the assumptions/calculations iHeart used to arrive at these numbers. IHM PFOF ¶ 177. As explained and shown in SoundExchange's Findings, these numbers reflect [redacted]; they do not reflect skip adjustments. SX PFOF ¶¶ 848-49. iHeart's own analysis proves that these rates are not [redacted] IHM PFOF ¶ 216. [redacted], (Hr'g Ex. SX-33 at 15-16, § 3(b)(i)-(ii)), [redacted] – a significant difference. Likewise, iHeart wrongly applies these skip-adjusted rates to [redacted] and wrongly [redacted]. *See* SX PFOF ¶¶ 849-50. *Even if* iHeart's [redacted]—they did not. *See* PAN ¶¶ 128.

[redacted] *Third*, iHeart insists that Warner's pre-deal share [redacted]. IHM PFOF ¶ 207-8. Only iHeart would have access to the specific market share of each rights owner on the iHeartRadio platform (as compared to the typical SoundScan market share data, which measures track sales, album sales, and other metrics

of market share more broadly and as a general matter). The internal documents reveal iHeart's assessment that [redacted] (Hr'g Ex. SX-90) or [redacted] (Hr'g Ex. SX-89 at 1). The additional "incremental" value to Warner was therefore greater than that represented in iHeart's projections or calculated by Profs. Fischel/Lichtman. iHeart's evidence to the contrary is a negotiated provision in the iHeart-Warner agreement [redacted]. *See* IHM PFOF ¶ 208 (citing a draft of the iHeart-Warner agreement, IHM 3010). In the ultimate agreement [redacted]. That is, iHeart ultimately recognized that [redacted]

868. *Fourth,* iHeart is simply wrong that Warner's expectations of the iHeart-Warner support the $0.0005 rate proposal. Prof. Fischel/Lichtman get to this conclusion by cherry-picking a single part of a single set of WMG projections. Specifically, Prof. Fischel testified that he relied on the particular [redacted] within one of the models attached to Mr. Wilcox's testimony because it was the case within [redacted]

[redacted]. IHM PFOF ¶ 191 (quoting Hr'g Tr. 5341:11-15 (May 21, 2015) (Fischel)). But that self-serving assumption did not correspond to Mr. Wilcox's testimony or any other evidence. The evidence actually showed that (1) the single case focused upon by Prof. Fischel, [redacted] (Hr'g Tr. 7421:14-20 (June 3, 2015) (Wilcox)); and (2) the comparable case to the [redacted] case that iHeart shared with its Board is the [redacted] (*see* Hr'g Ex. SX-367 at 5; (Hr'g Tr. 7552:5-7553:8 (June 3, 2015) (Wilcox) (explaining that [redacted])). Had Prof. Fischel conducted his incremental analysis using the [redacted], which Mr. Wilcox testified was the case reflected in the [redacted] then the Fischel/Lichtman analysis would have resulted in an incremental rate of ***$0.0045*** per performance. *See* SX PFOF ¶ 794 (calculating the incremental rate).

869. *Fifth*, Profs. Fischel/Lichtman's omit any value for key consideration that Warner received as a result of the direct license—consideration that is not a part of the statutory license. *See* SX PFOF § IX.C.2 ¶¶ 806-09. By Profs. Fischel/Lichtman's own definition this is "incremental" consideration. As calculated in SoundExchange's Proposed Findings of Fact, merely including [redacted] *See* SX PFOF ¶ 790 (calculations).

B. SoundExchange's Average Per-Performance Analysis Is The Correct Method For Analyzing The Benchmark Agreements

870. The incremental approach cannot be used to analyze the benchmark agreements in this proceeding and Profs. Fischel/Lichtman's application of the incremental approach to the iHeart-Warner agreement provides no useful information from which the Judges can determine the rates to which willing buyers and willing sellers would agree. The correct methodology as described herein looks to the *average effective rate* as calculated from both performance *and* expectations.

1. Analyzing Performance, Not Only Projections, Informs The Judges' Task Of Setting Rates For 2016-2020

871. SoundExchange provides three reasons as to why the Judges cannot discard performance-based analyses and the Services are wrong to suggest that they play no role in the rate-setting process here. *See* discussion in SX PFOF § IX.C.1 (¶¶ 796-805).

872. *First,* performance provides meaningful, objective, and unbiased information that courts, like parties to a hypothetical transaction, would take into account in setting the terms of that hypothetical agreement. *Lucent Techs., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1324 (Fed. Cir. 2009). Even if unforeseen circumstances result in actual performance divergent from expectations, the information is nonetheless relevant. *See Honeywell Int'l. Inc. v. Hamilton Sundstrand Corp.*, 378 F. Supp. 2d 459 (D. Del. 2005) (allowing the jury to consider post-negotiation projections even when the unforeseen event of September 11th resulted in performance greatly diverging from pre-deal expectations). Accordingly, iHeart's "critique" that "*ex post* outcomes are influenced by a number of factors that may not be anticipated by the parties that time of the agreement," and therefore is "not necessarily informative of what the parties were willing to *agree* to" is not a valid critique at all. IHM PFOF ¶ 197. Rather, courts take into account post-deal information even when unanticipated events occur. Even more true here, where the Judges are tasked with taking relevant *past* market data—including potentially

unrealistic or biased projections—and determining the rates to which willing buyers and sellers would agree in the *future*, the Judges should consider performance which is the objective measure of the effective rates to which the parties agreed.

873. *Second*, as an matter of economics, one would expect rational actors to learn from past agreements and performance data when negotiating an agreement today. *See* Hr'g Ex. SX-29 ¶ 27 (Rubinfeld Corr. WRT) ("The performance data reflect actual experiences in the marketplace. The most recent performance data is likely to be the best predictor of what will happen in the immediate future."). Prof. Katz explicitly agreed that it would be "sensible" and "reasonable" for parties to look to past performance of agreement to figure out if they turned out to be good rates and terms or not. Hr'g Tr. 3044:5-20 (May 11, 2015) (Katz).

874. *Third*, this is, in fact, what the market does. Mr. Cutler confirmed that, if he were creating the iHeart [ ] projection today, he would [redacted] Hr'g Tr. 7257:23-7258:9 (June 2, 2015) (Cutler). Likewise, Mr. Harrison testified that UMG is [redacted] Hr'g Tr. 977:4-14 (April 30, 2015) (Harrison). He said they can [redacted] *Id.*

875. The Judges must consider what willing buyers and willing sellers would agree to in a market (outside the shadow of the statutory license) for the 2016-2020 rate term. Like market participants, the Judges should take account of all the available evidence and most

current information *including* the actual performance of benchmark agreements. For the interactive agreements, the performance data merely confirms the minimum stated per-performance rates which provide the most reliable assessment—the agreement—of the rates to which the parties agreed. These rates, adjusted for additional functionality, provide the best measure of the market rates absent a statutory license. For Pandora and iHeart's proposed benchmarks, no analysis can cure the influence of the statutory license.

876. To the extent the iHeart-Warner and Apple agreements provide helpful information at all, the Judges should look to the average effective rates as expressed in both expectations and performance. The performance of these agreements—particularly when a [ ] favors a higher average effective rate.

2. Average Per-Performance Calculations Demonstrate That The iHeart-Warner Agreement Supports SoundExchange's Rate Proposal

a. *Analysis of the average effective per-performance rate based on actual performance*

877. Prof. Rubinfeld and Warner have both analyzed the performance of the iHeart-Warner agreement to date. These analyses are described in detail in SoundExchange's Proposed Findings of Fact Section IX.C.3 ¶¶ 833-45.

878. Prof. Rubinfeld separately calculated the average per-performance rate under the agreement for [ ] and [ ] performances from October 2013 to May 2014. He included a conservative value for the advertising provisions by valuing [ ]. Hr'g Ex. SX-64. For [ ]. Hr'g Ex. SX-66. For [ ]

[redacted]]. After adjustments for non-royalty bearing performances, the blended average adjusted per-performance rate is [redacted] for the eight-month period from October 2013 to May 2014. *Id.*

879. Similarly, as described and excerpted in SoundExchange's Proposed Findings of Fact, Warner calculated the average effective per-performance rate as of March 2014 and projected forward for the term of the agreement as [redacted]. Hr'g Ex. SX-296 at 15.

880. iHeart argues that Prof. Rubinfeld cannot be right that iHeart agreed to pay [redacted] per performance because that would be "irrational." IHM PFOF ¶ 195. However, iHeart fails to even address the core economic rationale as to why projections and performance could be so divergent—assumed risk. iHeart assumed a risk in [redacted] that the average effective rates would be much higher than the statutory rates based on certain levels of performance. Mr. Cutler acknowledged this risk: [redacted] Hr'g Tr. 7265:10-14 (June 2, 2015) (Cutler). iHeart's own [redacted]. *See* Hr'g Tr. 7264:22-7265:1 (June 2, 2015) (Cutler) [redacted]); *see* Hr'g. Ex. SX-221 (showing underlying assumptions for iHeart's [redacted] Case). Accordingly the average effective rates of [redacted] are well-within expectations and certainly not unreasonable given the [redacted]. Hr'g Ex. IHM 3338 (Cutler WDT).

b. Analysis of the average effective per-performance rate

881. Analyzing either iHeart's or Warner's expectations for the iHeart-Warner agreement likewise results in an effective average per-performance the corroborates SoundExchange's rate proposal starting at $0.0024 for the year 2016. Profs. Fischel/Lichtman calculate an expected average per-performance rate of [ ] from iHeart's [ ] projections.[49] Hr'g Ex. IHM 3034 at 23 ¶ 43 (Fischel/Lichtman AWDT).

882. Of course, Profs. Fischel/Lichtman omit key consideration that had significant value to Warner, including [ ]. Because these pieces of consideration would not be guaranteed under the statutory license, a benchmark rate must be adjusted upward to reflect the value that Warner actually receives from its direct license with iHeart. Adding each of these terms to Profs. Fischel/Lichtman's $0.0017 rate results in an effective rate of [ ] per performance, [ ]. SX PFOF ¶ 853; *see also* Hr'g Tr. 6284:20-25 (May 28, 2015) (Rubinfeld).

883. Analyzing Warner's expectations results in similar average effective per-performance rates. The [ ], results in an average effective royalty aligned with that which Prof. Rubinfeld calculated—[ ] per performance. As explained above, Profs. Fischel/Lichtman's reliance on the [ ] was wrongheaded and the [

[49] Had Profs. Fischel/Lichtman done a range of rates from other iHeart projections, they would have reported higher expected rates. The [ ] case would have resulted in average effective rates of [ ] per performance. Hr'g Ex. SX-131 at 5 (Prof. Rubinfeld's calculations of average per-performance rate under scenarios of iHeart projections not analyzed by Profs. Fischel/Lichtman). Likewise, [ ] case closely reflects actual performance of the agreement to date and results in an average expected per-performance royalty of [ ]. *Id.* at 4.

[redacted]]. Nonetheless, even analyzing the exact same case that Prof. Fischel identified from Mr. Wilcox's exhibits, the average expected per-performance royalty is [[redacted]] and [redacted]]. *See* SX PFF ¶ 857 (relying on Hr'g Ex. SX-92 at 15).

3. The Benchmark Analysis Must Account For All Consideration And Value Provided In The Benchmark Agreement That Is Not Provided By The Statutory License

884. iHeart, through Profs. Fischel/Lichtman acknowledge that a benchmark analysis must account for all the consideration exchanged—including any net value of non-royalty rate consideration. *See, e.g.*, Hr'g Ex. IHM 3034 ¶ 39 (Fischel/Lichtman AWDT); *see also* Hr'g Tr. 30396:3042:8 (May 11, 2015) (Katz). Profs. Fischel/Lichtman decline to make any adjustments upward or account for the value that Warner expected and did receive from the non-royalty rate provisions of the iHeart-Warner agreement. IHM PFOF ¶¶ 179-181 (recognizing that the "non-pecuniary" terms have value but declining to assign them any); *see also* Hr'g Tr. 5340:1-4 (May 21, 2015) (Fischel); Hr'g Ex. IHM 3034 at 20-21 (Fischel/Lichtman AWDT).

885. iHeart's argument for why Profs. Fischel/Lichtman were right to ignore the value of these provisions and why the Judges need not account for the substantial value provided to Warner by iHeart under the iHeart-Warner agreement is two-fold: (1) iHeart and Profs. Fischel/Lichtman recognize that the terms have value, but view the value as uncertain; and (2) they decline to engage in any exercise of determining that value because the parties purportedly did not value these terms in their contemporaneous projections[50] IHM PFOF ¶ 180-81 ("It is

[50] Profs. Fischel/Lichtman apply different criteria to the [redacted]], which appears as a line item in the model attached to Mr. Wilcox's testimony. With regard to that item of consideration, Profs. Fischel/Lichtman ignore it entirely despite it appearing in numerous Warner (footnote continued)

difficult to quantify the value of these 'insurance policies' and other non-pecuniary terms, but it is unnecessary to do so. Because both parties' contemporaneous projections assigned no net value to them, it is appropriate to assume that the net value of the provisions —some of which favor iHeartMedia, some of which favor Warner — is zero."); *see also* Hr'g Tr. 5339:20-25 (May 21, 2015) (Fischel)

886. iHeart gives no justification (economic, legal, or otherwise) as to why one would limit their analysis to the value of agreement terms as expressed only through those "contemporaneous projections" as compared to myriad other contemporaneous documents *including the agreement itself.* IHM PFOF ¶ 181. Numerous internal Warner document and documents shared between iHeart and Warner make clear that the non-royalty rate provisions had value. As noted above, the draft agreement that iHeart relies upon makes abundantly clear those terms that iHeart views as ["[redacted]

- [redacted]—that is, the [redacted];
- [redacted];
- [redacted]
- [redacted]
- [redacted] which were later [redacted].

Hr'g Ex. IHM 3010 at 10.

887. In both iHeart and Warner's [redacted]

[redacted]

projections and financial analyses. Hr'g Tr. 5378:18-25 (May 21, 2015) (Fischel) (discussing Hr'g Ex. SX-92 at 15); Hr'g Ex. SX-367 at 5.

[redacted]]. Hr'g Ex. SX-367; Hr'g Ex. IHM 3346 (redacting as privileged the additional information iHeart provided to its Board).

Warner's [redacted]]:

RESTRICTED GRAPHIC

[redacted]

Hr'g Ex. SX-367 at 5 ([redacted]]) (highlighting added). As the first bullet highlights: [redacted] *Id.* (emphasis added) In other words, the value from the advertising provisions [redacted].

888. If value can be expressed through the agreement terms themselves, testimony of those who negotiated the agreement and work for the companies involved, and contemporaneous

documents, Profs. Fischel/Lichtman have no excuse for not engaging in any attempt to value these terms at all. That terms have *unquantified* value does not mean they have *zero* value. To the contrary, the record makes abundantly clear that the net value of the provisions described below is [redacted] and therefore cannot be zero. Hr'g Tr. 7385:1-2 (June 3, 2015) (Wilcox).

889. SoundExchange's Proposed Findings of Fact (Section IX.C.2 (¶¶ 806-32) details each of these omitted items of consideration and the substantial value they conferred upon Warner. This section will not repeat the substantial evidence detailed in SoundExchange's Findings, but incorporates the prior discussion by reference and notes each provision here:

- [redacted]. Hr'g Ex. SX-33 at 2, § 1(e); 11, § 1(qq).
- [redacted]. As Mr. Wilcox explained this is a crucial economic term to establish *market precedent* going forward as advertising moves to the digital world.[51] Hr'g Tr. 7405:16-7406:3 (June 3, 2015) (Wilcox).
- [redacted] was downside protection but it also meant that [redacted]. Hr'g Ex. SX-33 at 17, § 3(d).
- [redacted] likewise provided Warner with downside protection [redacted]. Hr'g Ex. SX-33 at 16, § 3(c).

[51] iHeart *now* asserts that Warner negotiated this term as precedent for these CRB proceedings. IHM PFOF ¶ 212. Yet, iHeart cites no fact witness testimony whatsoever on this point. As Mr. Wilcox explained, the negotiation of this term was important *market* precedent, not CRB precedent. Hr'g Tr. 7405:16-7406:3 (June 3, 2015) (Wilcox).

- [redacted] Hr'g Ex. SX-33 at 28, § 10(c); see also Hr'g Ex. SX-32 at 14 (Wilcox WRT).
- [redacted] are compensable under the iHeart-Warner agreement. Hr'g Ex. SX-33 at 10, § 1(pp); Hr'g Ex. SX-32 at 14 (Wilcox WRT).
- [redacted] is provided in [redacted]. Hr'g Ex. SX-33 at 19-20, § 5(a).
- [redacted] Hr'g Ex. SX-32 at 14 n.9 (Wilcox WRT); Hr'g Tr. 7403:4-21 (June 3, 2015) (Wilcox).
- [redacted] provided that much in additional [redacted] to Warner that it would not have received absent the agreement. *See, e.g.*, Hr'g Ex. IHM 3320.

890. iHeart does not argue that these terms do not have value or offer testimony refuting that Warner placed value on these terms. iHeart did not provide any evidence—apart from Prof. Fischel's conclusory assessment that collectively it is appropriate to assume they have a net value of zero—as to whether (and if so how much) value iHeart placed on the provisions benefiting it [redacted]. *See* IHM PFOF ¶ 179 (quoting only Prof. Fischel's assessment that [redacted]).

891. Rather, iHeart maintains its argument that [redacted]. IHM PFOF ¶ 180 These terms are not similar. In stark contrast to the [redacted]. *See* SX PFOF ¶ 822 (citing

Hr'g Tr. 5340:20-5341:3 (May 21, 2015) (Fischel) [redacted]

[redacted]]).

892. iHeart further claims that Prof. Rubinfeld was wrong to value [redacted]

[redacted] IHM PFOF ¶ 198 (citing Hr'g Tr. 5348:4-8 (May 21, 2015) (Fischel)). Apparently, however, [redacted]

[redacted]. Hr'g Ex. SX-33 at 19-20, § 5(a) The single document iHeart cites—iHeart Exhibit 3121 in paragraph 199 of iHeart's Findings—[redacted]. Hr'g Tr. 7390:5-11 (June 3, 2015) (Wilcox) (describing the document as a [redacted]

[redacted]). iHeart further ignores the substantial testimonial and documentary evidence that Warner viewed this term as having additional value. *See* SX PFOF ¶¶ 815-26 (discussing the substantial value these provisions had to Warner above and beyond "insurance" value).

893. iHeart further argues that the [redacted]

[redacted] IHM PFOF ¶ 206. The documents tell a different story—they show that iHeart offered [redacted] (Hr'g Ex. IHM 3320) and as Mr. Wilcox testified, [redacted] (Hr'g Tr. 7387:8-12 (June 3, 2015) (Wilcox)). *See also* SX PFOF ¶ 828-31 (further discussing the value of the

[redacted]]. Moreover, this is the one instance in which Profs. Fischel/Lichtman apparently break their own rule—they are otherwise content to accept whatever the parties represent in their contemporaneous projections *but for* this [redacted]]. *See* Hr'g Ex. SX-92 at 15.

894. Finally, iHeart refuses to admit that the [redacted] in the iHeart-Warner agreement has any value at all. IHM PFOF ¶ 211. iHeart offers that neither party expected it to become binding, but fails to cite any fact testimony when [redacted]]. *See* Hr'g Tr. 7405:16-7406:3 (June 3, 2015) (Wilcox). Furthermore, that iHeart explicitly argues that Warner used some of its [redacted] is further proof that it has additional value above and beyond the per-performance rates—why else would Warner [redacted]? *See* IHM PFOF ¶ 212.

895. iHeart's only new argument as to why these terms have no value is that Prof. Rubinfeld did not value these provisions. IHM PFOF ¶ 205-6. This misses the point. That Prof. Rubinfeld was conservative in analyzing the iHeart-Warner agreement does not mean that the core economic terms did not provide substantial consideration to Warner. They did. That Prof. Rubinfeld did not put a monetary value on these provisions in his average effective rate analysis but believes that they do in fact have value—"Again, just to make the record clear, didn't assign a numerical value. I think it has value. I don't have much doubt about that, but I don't know the exact dollar amount"—just proves that his calculations are conservative and Profs. Fischel/Lichtman's are biased downward. *See* Hr'g Tr. 6437:12-15 (May 28, 2015) (Rubinfeld).

C. iHeart's "Incremental" Analysis Of The iHeart-Independent Agreements And The Pandora-Merlin Agreement Is Equally Flawed

1. The iHeart-Independent Agreements Are Not Representative

896. iHeart offers its agreements with Independent record labels as confirmatory evidence of the iHeart-Warner benchmark agreement. These agreements, like the Pandora-Merlin agreement, are not indicative of the overall market for webcasting because they cannot be extrapolated to the rates and terms to which a major record label would agree. As iHeart admits, the agreements with independents account for a much smaller percentage of the market and iHeart's performances than the agreement with Warner. The *increased* share of performances was still only [ ]. IHM PFOF ¶ 213; *see also* Hr'g Ex. IHM 3034 fn. 62 (Fischel/Lichtman AWDT) (the 27 independent labels are "small, with at most a few well-known artists signed to each label.").

897. [ ]. *See* SX PFOF ¶ 862. iHeart admits this fact—it finds that [ ]. IHM PFOF ¶ 174.

898. The rate differential would hold even if Profs. Fischel/Lichtman assigned value to the non-pecuniary terms in the iHeart-Independent agreements. Yet, iHeart makes no effort to value any of the consideration provided to the independent labels, just as true with the iHeart-Warner agreement, and "assume[s] the non-pecuniary terms have a net value of zero" because they "cannot be precisely quantified." Hr'g Ex. IHM 3034 ¶ 62 (Fischel/Lichtman AWDT) [ ]").

2. iHeart's Description Of Profs. Fischel/Lichtman's Analysis Of The Independent Deals Is Not Accurate; Nonetheless, Profs. Fischel/Lichtman's Assumption Are Unreasonable

899. iHeart's Proposed Findings of Fact describe Profs. Fischel/Lichtman's analysis of the iHeart-Independent agreements as "examining documents describing iHeartMedia's pre-deal expectations for the agreements." IHM PFOF ¶ 218. That is not what Profs. Fischel/Lichtman did. Profs. Fischel/Lichtman looked at *post-deal* performance and assumed a [ ] uplift from those numbers. Hr'g Ex. IHM 3034 ¶ 63 (Fischel/Lichtman AWDT). Profs. Fischel/Lichtman cite no pre-deal documents in their written or oral testimony whatsoever regarding these expectations precisely because no such documents were available. In fact, Profs. Fischel/Lichtman testify:

[ ].

Hr'g Ex. IHM 3034 ¶ 63 (Fischel/Lichtman AWDT).

900. Accordingly, Profs. Fischel/Lichtman base their analysis on an understanding of expectations rather than any document at all. They have no documents from the independent labels and cite no testimony confirming the actual anticipated uplift in performances.[52] Profs. Fischel/Lichtman analyze the iHeart-Independent agreements' *as if* the shared pre-deal

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[52] [ ] IHM PFOF ¶ 223 (quoting Mr. Lexton discussing the Pandora agreement and Pandora-Merlin emails). These documents do not speak to iHeart's or the Independent record labels' actual expectations.

expectation was to perform the independent labels at an increased share of [ ]. Hr'g Ex. IHM 3034 ¶ 64 (Fischel/Lichtman AWDT).

901. Yet, the single document that Profs. Fischel/Lichtman do rely upon counters the reasonableness of this assumption because iHeart [ ]. Profs. Fischel/Lichtman acknowledge this, explaining that [ ]. Hr'g Ex. IHM 3034 fn. 65 (Fischel/Lichtman AWDT).

902. For all the reasons that the iHeart-Warner agreement and the incremental analysis of it are unhelpful to the Judges, so too for the iHeart-Independent agreements. These agreements are even less helpful as they evince less of the market and were not based on any pre-deal expectation documents *or* actual performance data at all.

3. The Pandora-Merlin Agreement Does Not Support iHeart's Rate Proposal

903. The facts and arguments for not relying on the Pandora-Merlin agreement as a benchmark is described fully in Section IV, *supra*. iHeart's only additional argument is that the Pandora-Merlin agreement provides "direct evidence in support of the 'incremental' methodology used by Professor Fischel." IHM PFOF ¶ 228. This is false.

904. Pandora and Prof. Shapiro never endorsed Profs. Fischel/Lichtman's incremental analysis of the Pandora-Merlin agreement and there has not been any testimony [ ].

905. The exact same reasons that the incremental approach fails to be an appropriate benchmark methodology described in subsection V.A. *supra*, apply with equal force to the Pandora-Merlin proposed benchmark. iHeart contends that particular testimony regarding the [ ]. IHM PFOF ¶ 229. iHeart, however, cites no testimony or evidence (nor can it) that [ ]. To the contrary, the testimony iHeart quotes shows that the agreement [ ]. *See, e.g.*, Hr'g Tr. 6962:9-14 (June 1, 2015) (Lexton) ( ] (emphasis added); Hr'g Tr. 7113:3-7114:21 (June 1, 2015) (Wheeler)]). iHeart provides no evidence that any party would accept a rate at or near $0.0005 (let alone [ ]) for only those performances in the purported second bundle.

906. As true of Profs. Fischel/Lichtman's analysis of the iHeart-Warner and iHeart-Independent agreements, they leave out consideration that would require an adjustment upward. Profs. Fischel/Lichtman merely take the [ ]. This makes no economic sense. That Merlin would give decreased rates for [ ]. *Supra* Section V.B.3.

D. Profs. Fischel/Lichtman's Purported "Other Economic Evidence" Does Not Provide Reliable Economic Evidence Of The Rates And Terms To Which Willing Buyers And Willing Sellers Would Agree

1. Profs. Fischel/Lichtman's "Thought Experiment" Provides No Useful Information Regarding Actual Streams Of Revenue To The Recorded Music Industry

907. As iHeart concedes, Profs. Fischel/Lichtman's "Thought Experiment" is "not evidence of what a willing buyer and willing seller would negotiate." IHM PFOF ¶ 241 (citing Hr'g Ex. IHM 3034 ¶ 128 (Fischel/Lichtman AWDT)). Likewise, the Thought Experiment as iHeart describes it "obviate[s] the promotion/substitution debates for the purposes of the experiment."[53] IHM PFOF ¶ 239 (citing IHM 3034 ¶ 125 (Fischel/Lichtman AWDT)). Therefore, the Thought Experiment is irrelevant as a matter of law because it fails to address any of the relevant economic standards governing this proceeding.

908. The Thought Experiment is further not helpful because it demonstrates only the obvious and irrelevant point that *some* revenue from the exploitation of sound recordings is better than *none*. iHeart through Profs. Fischel/Lichtman admit that

> [t]he essential reason for [the low rates that the Thought Experiment derives] is that, before the migration from terrestrial radio, copyright holders received ***no compensation for radio airplay***, but after the migration to webcasting, ***copyright holders will receive a royalty***. Therefore, even if webcasting decimates

[53] To the extent that iHeart nonetheless argues that the Thought Experiment shows statutory services are net "promotional" or "accretive" to revenue, it improperly conflates purported *migration* from terrestrial radio to digital streaming services with *substitution.* The argument goes: Webcasting is a higher revenue-generating substitute for terrestrial radio and, therefore, the impact is net positive when a listener migrates from terrestrial radio to webcasting. This argument, however, misses the question of substitution *entirely*. Every purportedly "new migration" from terrestrial radio presents a choice between a directly licensed service and a statutory webcaster; it is *that choice* not the "migration" which asks the question of substitution. For every user that chooses a statutory webcaster over a directly licensed service, record labels lose the potential revenue from a converted paid subscriber and the greater average revenue paid by those directly licensed services.

> music sales and other revenue-generating activity, the per-performance royalty necessary to keep copyright holders 'whole' is not high.

IHM 3034 ¶ 126 (Fischel/Lichtman AWDT) (emphasis added). As a legal matter, this revenue is irrelevant to the § 114(f)(2)(B)(i) inquiry because terrestrial radio is not a "stream of revenue." Rather, the exploitation of sound recordings on terrestrial radio is irrelevant because Congress has not conferred a performance right in terrestrial broadcasts. Because it can neither be interfered with nor enhanced as a stream of revenue, performances on terrestrial radio are not relevant for the promotion/substitution analysis.

909. Even if somehow relevant, the Thought Experiment is biased in execution toward finding a lower rate. Profs. Fischel/Lichtman provide no basis for assuming that *all* terrestrial radio listening would transition to webcasting nor do they provide a basis for assuming that recorded music companies would price this migrated listening time at $0. *See* Hr'g Ex. SX-29 ¶¶ 100-101 (Rubinfeld Corr. WRT). It is purely the fact that Profs. Fischel/Lichtman assume a migration of all listener hours but no substitution for revenue (because there is no revenue from terrestrial radio) that they reach the conclusions they do. If instead, they were to look at only the transition of non-radio listening (CDs, streaming subscriptions, and other) and revenue, at 100% substitution, the rate would need to be $0.0046 to account for the lost revenue. If the rate of substitution were 50% the rate would need to be $0.0023.

910. Furthermore, iHeart's additional iteration of the Thought Experiment in which purportedly only 25% of revenue-generation is lost has no principled rational at all. First, it appears Profs. Fischel/Lichtman intended to run the calculation at 50%, which would have resulted in a rate only marginally lower than full substitution at $0.0012.

Exhibit F
Per-Performance Royalty Payment Sufficient to Compensate
Copyright Holders for Hypothetical Loss of Other Revenue Due to Migration to Webcasting

		Migration from Terrestrial Radio to Webcasting:		
		Does Not Reduce Copyright Holder Revenues	Reduces Copyright Holder Revenues by 100%	Reduces Copyright Holder Revenues by 50%
2013 Recorded Music Industry Revenues (MM $)[1]	[1]	$6,996	$6,996	$6,996
Sound Exchange Distributions (MM $)[1]	[2]	$590	$590	$590
Non-SoundExchange Recorded Music Industry Revenues (MM $)	[3] = [1] - [2]	$6,406	$6,406	$6,406
2013 U.S. Population (MM)[2]	[4]	255.0	255.0	255.0
Average Industry Revenue per Person	[5] = [3] / [4]	$25.12	$25.12	$25.12
Average Hours per Day of Radio Music Listening, per Person[3]	[6]	2.3	2.3	2.3
Average Hours per Year of Radio Music Listening, per Person	[7] = [6] x 365	839.5	839.5	839.5
Average Hours per Day of Non-Radio Music Listening, per Person[4]	[8]	1.0	1.0	1.0
Average Hours per Year of Non-Radio Music Listening, per Person	[9] = [8] x 365	365.0	365.0	365.0
Assumed Additional Webcasting Hours per Year from a New Adopter	[10]	839.5	1,204.5	1,022.0
Assumed Consequent Reduction in Non-Radio Music Listening and Purchases	[11]	0%	100%	25%
Reduction in Recorded Music Industry Revenue, per Person	[12] = [11] x [5]	$0.00	$25.12	$6.28
Royalty per Listener-Hour Sufficient to Compensate for Assumed Reduction in Revenue	[13] = [12] / [10]	$0.0000	$0.0209	$0.0061
Assumed Webcast Songs per Listener-Hour	[14]	15.0	15.0	15.0
Royalty per Performance Sufficient to Compensate for Assumed Reduction in Revenue	[15] = [13] / [15]	$0.0000	$0.0014	$0.0004

Sources and Notes:

1 RIAA shipments data, in 2013 inflation-adjusted dollars. Includes all revenue sources except Sound Exchange Distributions.

2. Civilian noninstitutionalized population aged 15+, including armed forces living off post or with families on post. Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, 2013. Total population of 316.1 MM, less population under 15 years (61.1 MM) = 255.0 MM.

3. "State of the Media: Audio Today 2014." Nielsen, February 2014 (indicating 2.7 hours of radio listening per person per day, and indicating shares of total stations with non-music formats, including News/Talk (11.3 percent), Sports (3.1 percent), and All News (1.5 percent). The sum of these is 15.9 percent, leaving 84.1 percent of stations as music format). 84.1 percent of 2.7 hours is 2.3 hours.

4. Edison Research "Share of Ear" Study Release Announcement dated June 18, 2014 (noting 4.1 total hours of music listening per person per day, with 20.3 percent for owned music and 5.2 percent for TV music).

Hr'g Ex. 3034 at 182 (Fischel/Lichtman AWDT Ex. F) (highlighting added). Profs. Fischel/Lichtman provide no rationale for their choice to use 25% rather than 50%, but it appears that it was only to achieve a number closer to $0.0005. Had they chosen 50%, as described above, it would *not* have supported iHeart's rate proposal.

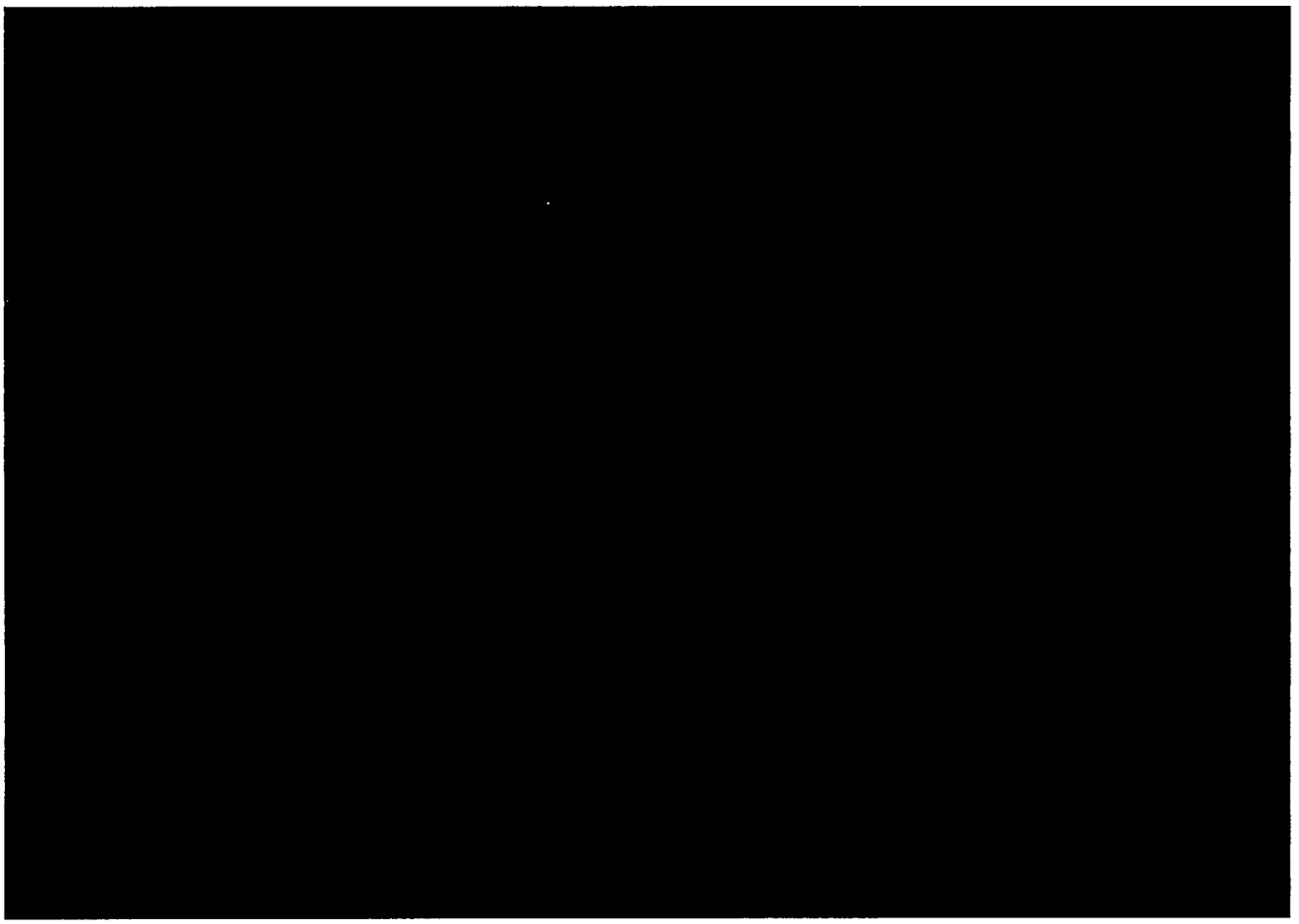
911. Second, Profs. Fischel/Lichtman provide no justification for their assumption of 1,022 hours of webcasting listening per year from new adopters. That is, they assume 84% of the listening time transitions to webcasting but only 25% of revenue. If, instead, they had used 25% of the time, or 301.1 hours, the exact same calculation results in a rate of $0.021.

912. Finally, the Thought Experiment is not supported by internal company documents. iHeart contends that Profs. Fischel/Lichtman's analysis is "one that the record labels have independently used" and is therefore credible and relevant. IHM PFOF ¶ 243. iHeart provides none of the context that Mr. Wilcox gave during his hearing testimony: As Mr. Wilcox

explained, [ ]. *Id.* at 2419:24 (May 7, 2015) (Wilcox). Likewise, Warner [ ]. *Id.* at 2421:21-2422:2. Warner was also looking for the transition of [ ]. *Id.* 2422:7-12. Finally, as iHeart told Warner and as iHeart's own document show, [ ]. Hr'g Tr. 2420:12-17.

913. iHeart's own internal documents do not support the assumptions of the Thought Experiment.

RESTRICTED GRAPHIC



Hr'g Ex. SX-196 at 5. iHeart told record labels that [redacted]; in other words, digital does not substitute for broadcast radio.

2. Profs. Fischel And Lichtman's EVA Analysis Does Not Support iHeartMedia's Rate Proposal

914. iHeartMedia relies on Profs. Fischel and Lichtman's flawed Economic Value Added ("EVA") analysis to support its rate proposal. But this approach is incompatible with the willing buyer/willing seller standard. In addition, Prof. Lys demonstrates that Profs. Fischel and Lichtman's approach is not a "useful application[]" of EVA and it contains serious methodological flaws. Hr'g Ex. SX-28 ¶ 150 (Lys WRT).

915. Profs. Fischel and Lichtman performed an EVA analysis to determine the purported maximum royalty rate that a "hypothetical simulcaster" could pay while earning an economic profit. IHM PFOF ¶ 247. "To calculate this purported maximum rate, Profs. Fischel and Lichtman constructed a model based on the economic profits and listenership of the terrestrial radio industry." Hr'g Ex. SX-28 ¶ 150 (Lys WRT). As Prof. Lys explained, Profs. Fischel and Lichtman model their hypothetical simulcaster by "starting with the revenues, expenses, and capital of twelve terrestrial broadcasters" and then attempting to "'back out' certain expenses and capital items that would be inapplicable to a webcaster, such as FCC license costs." *Id.* ¶ 155.

916. The Judges have already concluded that an approach that seeks to isolate a webcaster's costs and then determine the royalty rate that would generate a profit is incompatible with the statutory standard: "Rate-setting proceedings under section 114 of the Act are not the same as public utility proceedings. . . . The Judges are not to identify the buyers' reasonable other (non-royalty) costs and decide upon a level of return (normal profit) sufficient to attract capital to the buyers." *Web III Remand*, 79 Fed. Reg. at 23107. This is precisely the approach

taken by Profs. Fischel and Lichtman—they attempt to identify the non-royalty costs of a hypothetical simulcaster, and they then seek to determine the maximum royalty that this hypothetical simulcaster could pay while earning an economic profit—i.e. a profit sufficient to cover its cost of capital.

917. In addition, Prof. Lys identified serious flaws in Profs. Fischel and Lichtman's analysis. iHeartMedia has failed to respond to many of these criticisms, which demonstrate that Profs. Fischel and Lichtman's analysis is unreliable and irrelevant.

a. Profs. Fischel And Lichtman Ignored Fundamental Differences Between Webcasting And Terrestrial Radio

918. "Professor Fischel & Lichtman's analysis is based on the key assumption that their 'hypothetical simulcaster,' which is modeled on the terrestrial industry, has the same revenue and cost structure of a real webcaster." Hr'g Ex. SX-28 ¶ 157 (Lys WRT). But "[t]his assumption is completely unwarranted." *Id.* As Prof. Lys explained:

> Analyzing the terrestrial radio industry to determine the cost structure of the webcasting industry is like examining the horse and buggy industry to learn about the automobile industry. Webcasting and terrestrial radio simply have too many differences in their cost structure, geographic scope, and the value proposition they offer consumers and advertisers.

Id. ¶ 151.

919. For example, Prof. Lys noted that webcasters can take advantage of scale in a way terrestrial stations cannot. *Id.* ¶¶ 167-70. Terrestrial radio stations are geographically constrained and, as a result, can grow only to a certain size or listenership. *Id.* If a terrestrial station wants to enter a new geographic market, it must incur costs to enter that market. *Id.* By contrast, a webcaster does not have the same entry costs and can compete on a national level. *Id.*

920. Profs. Fischel and Lichtman admit that webcasters do not face the same entry costs and can compete on a national level: "webcasters do not face the same type of barriers to

entry (in the form of scarce FCC licenses, major capital expenditures, and limitations on any station's geographic reach) that terrestrial radio broadcasters face." Hr'g Ex. IHM 3034 ¶ 99 (Fischel & Lichtman Amended WDT). Yet their analysis fails to take into account this structural difference between webcasting and terrestrial radio.

921. Similarly, webcasters, unlike terrestrial broadcasters, can "target" their advertising to individual users to maximize the value of their advertising. Hr'g Ex. SX-28 ¶¶ 180-82 (Lys WRT). There is significant evidence that this ability to target is valuable to advertisers. Michael Herring testified as to how targeting enables Pandora to command higher advertising premiums: "[Our] ability to target specific audiences enables us to attract advertising, as well as obtain higher rates for those ads, because advertisers know that their ads are being delivered to those listeners that are most likely to be consumers of their products." Hr'g Ex. PAN 5016 ¶ 31 (Herring AWRT). Similarly, Prof. Rysman testified that "[s]eller learning is particularly valuable to advertising-based services." Hr'g Ex. SX-18 ¶ 27 (Rysman WRT). "Advertisers often value the ability to show advertisements to consumers who are most likely to be interested." *Id.*

922. Again, Profs. Fischel and Lichtman recognize this flaw in their model: "Arguably, simulcasters could one day have an advantage over terrestrial radio if their advertisements could be targeted more precisely to specific listeners than are terrestrial radio advertisements." Hr'g Ex. IHM 3034 ¶ 99 (Fischel & Lichtman Amended WDT). Yet, again, they do not account for this major difference between terrestrial broadcasts and webcasts.

923. iHeartMedia's own Proposed Findings of Fact acknowledge that webcasting has many appealing features that distinguish it from terrestrial radio, including higher sound quality,

the ease of moving from home to office to workout, and the ability to reach global audiences. IHM PFOF ¶ 26. Yet Profs. Fischel and Lichtman simply ignore these differences.

924. Prof. Lys also demonstrates that the labor needs of webcasting and terrestrial radio are wildly different. Based on Bureau of Labor statistics and Pandora's employment numbers, Prof. Lys shows that webcasting is nearly 10 times more efficient than terrestrial broadcasting. Hr'g Ex. SX-28 ¶ 187 (Lys WRT). Unlike terrestrial stations that have to hire DJs and engineering staff for each station and city, webcasters can broadcast on a national scale from a single location. *Id.* ¶ 186.

925. In their Proposed Findings of Fact, iHeartMedia attempts to blunt Prof. Lys's criticisms by arguing that "Professors Fischel and Lichtman "'acknowledged'" these potential differences, but found that their net effect is 'unclear.'" IHM PFOF ¶ 256. They then criticize Prof. Lys for not demonstrating "otherwise"—i.e. not demonstrating the precise effect of these differences on the EVA analysis. *Id.*

926. Respectfully, this not Prof. Lys's or SoundExchange's burden to bear. Prof. Lys is not the one offering an EVA analysis in support of SoundExchange's rate proposal. Rather, it is Profs. Fischel and Lichtman who are asserting that the terrestrial radio industry and the webcasting industry are sufficiently similar to permit them to identify a webcaster's costs by examining the terrestrial broadcast industry's costs. Prof. Lys has identified serious structural differences between webcasting and terrestrial radio that, in his opinion, render these industries fundamentally dissimilar. Profs. Fischel and Lichtman do not dispute that these differences could exist, yet have done nothing to account for them. They have not met their burden of showing that their analysis is reliable and useful.

b. Profs. Fischel And Lichtman's EVA Analysis Ignores Fundamental Principles Of Supply And Demand

927. Prof. Lys testified that, in equilibrium, EVA must be zero for the marginal firm. Hr'g Ex. SX-28 ¶ 191 (Lys WRT). This is true regardless of the rate set by the CRB. *Id.* ¶ 192. Lowering the royalty rate will attract more firms to the market until EVA returns to zero. *Id.*. Conversely, increasing the royalty rate will encourage the most inefficient firms to exit the market until EVA returns to zero. *Id.* Accordingly, an EVA-based approach "cannot offer any rate setting guidance unless one makes the additional stipulation that the current, marginal firm must survive." *Id.* Of course, the Judges have explicitly rejected a royalty approach that seeks to keep any particular firm in business. *Web III Remand*, 79 Fed. Reg. at 23119.

928. iHeartMedia's Proposed Findings of Fact do not respond to this aspect of Prof. Lys's criticism. Instead, they criticize Prof. Lys for assuming "that a hypothetical simulcaster actually earns a positive EVA, but then loses it." IHM PFOF ¶ 255. This response fundamentally misunderstands Prof. Lys's analysis, which focuses on the lack of any logical connection between Profs. Fischel and Lichtman's EVA approach and the statutory standard.

c. Prof. Lys Identified Other Significant Flaws In Profs. Fischel And Lichtman's EVA Analysis

929. Finally, Prof. Lys showed that there are significant technical problems with the way Profs. Fischel and Lichtman applied their EVA analysis. Hr'g Ex. SX-28 ¶ 200–12 (Lys WRT). Most significantly, Profs. Fischel and Lichtman's model is unduly sensitive to outliers in their sample. iHeartMedia is a "dramatic outlier in their sample, having by far the lowest EVA at 1.06%." *Id.* ¶ 202. Excluding this single outlier *doubles* the rate obtained under Profs. Fischel and Lichtman's model. *Id.* Based on this result, Prof. Lys concluded: "this model is completely unreliable and uninformative. If excluding a single outlier more than *doubles* the royalty calculation we cannot trust that this model has any accuracy." *Id.* ¶ 204. Prof. Lys's analysis on this point goes completely unanswered in iHeartMedia's Proposed Findings of Fact, with the

exception of iHeartMedia's cryptic and unsupported assertion that "Professor Lys's remaining criticisms cut against him." IHM PFOF ¶ 257.

VI. NAB'S RATE PROPOSAL AND SUPPORTING EVIDENCE DO NOT REFLECT THE RATES AND TERMS THAT WOULD BE NEGOTIATED BY WILLING BUYERS AND SELLERS ABSENT THE STATUTORY LICENSE

930. NAB contends that "simulcasters" should not pay the same rates as other webcasters for the performance of the same sound recordings. NAB's justification for this proposed segmentation of the statutory rate turns on a single core argument: "simulcast" is the same as terrestrial broadcast radio, only delivered through a different medium. According to NAB, convergence should have no bearing on its rate, because simulcasters simply broadcast radio through another device – no more, no less. Because terrestrial radio (NAB contends) is more promotional than substitutional, simulcast must also be more promotional than substitutional. And because terrestrial radio (NAB contends) provides a public benefit consisting of local, community service information, simulcast must also provide such a public good.

931. NAB's focus on terrestrial radio and its purported benefits are not market-based arguments; they are policy arguments reflecting the NAB's belief that broadcasters are entitled to play music for free on any platform of their choosing. That is plainly not the law, as SoundExchange explains in further detail in its Conclusions of Law. *See* SoundExchange Reply Conclusions of Law, Section IV. Contrary to NAB's assertions, the applicable statute does not compel the Judges to afford simulcasters a lower rate. *Id.* at Section V. The policy arguments NAB makes have no place in the statutory standard the Judges are charged with applying, which asks: What rate would a willing record company (or recording artist) and a willing simulcaster agree to in a market unencumbered by the statutory license in an agreement that will cover the next five years?

932. In Section VI.A. *infra*, SoundExchange explains that a licensor's approach to this question necessarily would consider the broader market—not just the simulcaster's individual service offering. NAB cannot isolate simulcasts from the broader market by claiming that simulcasts are isolated from and unaffected by the convergence of service offerings in the market, nor by contending that they are identical to terrestrial broadcasts in all respects. In Section VI.B, *infra*, SoundExchange refutes the NAB's contentions—none of which are supported by *market* evidence—as to why simulcasters should pay lower rates than other webcasting services. In Section VI.C, *infra*, SoundExchange explains why the Judges should reject a segmented rate structure. And in Section VI.D, *infra*, SoundExchange explains why the NAB's characterizations regarding the Webcaster Settlement Act agreements are unfounded.

933. NAB also attempts to justify its plea for lower rates by pointing to simulcasters' alleged lack of profitability, contrasted with what it claims is the ability of record companies to pay higher rates. Sections II.B.4 and II.B.5, *infra*, address those claims. And NAB's contentions as to proposed benchmarks proffered by other services are dealt with in the primary sections dealing with those proposed benchmarks.

A. In A Willing Buyer/Willing Seller Transaction Unencumbered By The Statutory License, Licensors Would Treat Simulcasters As They Would Any Other Participants In The Overall Internet Radio Landscape

934. NAB's repeated theme is that its members offer terrestrial radio delivered through another means, and as such should receive some special treatment among other internet radio participants. NAB's efforts attempt to downplay the mode of delivery, but that matters under the law. *See* SoundExchange Reply Conclusions of Law, Section IV. And it matters to the central question here of what a willing buyer and willing seller would agree to absent the statutory license. NAB does not present evidence that licensors consider simulcasters to be just like terrestrial broadcasters, entitled to special treatment. When the relevant statutory standard is

considered—in the light of how licensors have explained they approach market negotiations—NAB's plea for special treatment necessarily must be rejected as inconsistent with how the willing buyers in this transaction would approach the deal.

1. Licensors Would Consider Simulcasters In The Context Of The Larger Internet Radio Market, With An Eye Towards Their Future Development.

935. Licensors approach negotiations with the *entire* market in mind—not just the single product or offering in isolation. As Ron Wilcox explained, WMG "views each potential distribution model in terms of its impact on all other distribution channels." Hr'g SX-Ex. 22 at 5 (Wilcox WDT). Aaron Harrison of Universal testified that his department "seek[s] to ensure that services to which Universal grants the right to use sound recordings will generate revenue and not just divert revenues from other forms of exploitation, including from higher ARPU subscription streaming services." Hr'g Ex. SX-10 ¶ 16 (Harrison Corr. WDT).

936. This inquiry necessarily is forward-looking, considering how a service would plan to compete and develop over the term of the agreement. Mr. Harrison testified that UMG would consider a service's "funding sources, their management, their business model, plans for scaling the service and increasing revenues over time, as well as how they will distinguish their service from others on the market." Hr'g Ex. SX-10 ¶ 23 (Harrison Corr. WDT). As Mr. Wilcox stated, "[e]ach business that WMG authorizes to exploit its content needs to provide a distinct revenue stream that either contributes meaningfully to WMGs bottom line, *or that has the realistic potential to develop a business model that, over time, is likely to make such a contribution.*" Hr'g Ex. SX-22 at 5 (Wilcox WDT) (emphasis added).

937. In a hypothetical negotiation, licensors would consider how the service will affect their business on other services, both as of today and over the ensuing term. That matters when considering what rate licensors would agree to afford simulcasters, just as it matters in

considering any other webcaster. As Prof. Shapiro recognized, the "opportunity cost of licensing to [one] customer is going to depend on the rate set to other customers and the diversion between the target customer and other customers." Hr'g Tr. 4910:23-4911:10 (May 20, 2015) (Shapiro). That principle means simulcasters cannot be isolated from the rest of the market for internet music services. NAB's claim that convergence is "completely inapplicable to simulcasting" cannot insulate simulcast from market realities. NAB PFOF ¶ 3 (emphasis omitted).

938. NAB's focus on its claims of simulcasters' limited functionality today ignores simulcasters' place in the larger internet radio market. By claiming a discount based on the functionality and customization simulcasters do or do not permit today, NAB does not approach the question of what rate should apply the way a licensor would. A licensor would not subsidize lesser-value services and potentially risk competitively harming its target customers. As explained in SoundExchange's Proposed Findings, in the hypothetical market, a one-stop, platform-level service that either (i) has a higher willingness to pay because of the horizontal nature of its business, or (ii) pushes users towards high-value modes of consumption, whether downloads or subscriptions, is naturally going to be the "target customer" of a willing seller. And in a willing buyer/willing seller negotiation in the absence of the statutory license, an economically rational record company would not give a statutory service—including a simulcaster—a competitive advantage over its preferred, "target customers." *See* SX PFOF ¶ 311-12.

939. The functionality a simulcaster elects to adopt is only half the story. The other half is what movement so-called "interactive" services have made toward the functionality that traditional simulcast has offered. "Interactive" services no longer simply feature "on-demand" functionality that allows listeners to request the exact song they want to hear. Hr'g Ex. SX-17 ¶¶

37, 55 (Rubinfeld Corr. WDT). Rather, interactive services have "been focused on" developing curated and editorial lean-back offerings "to complement [the] lean-forward experience that they provide." Hr'g Tr. 378:6-21 (Apr. 28, 2015) (Kooker); Hr'g Tr. 6569:15-6570:23 (May 29, 2015) (Kooker). The availability of those curated, "lean-back" offerings on higher-revenue-earning services directly affects what a licensor would be willing to accept for its content to a competing service—including the simulcast offerings that are NAB's focus.

940. NAB attempts to define the inquiry as whether a stream of a terrestrial broadcast—with no differences in the content of the over-the-air broadcast—has different features and functionality than what a user can obtain from a so-called "interactive," "custom" or "lean-forward" service. That is not the right question, because it does not accurately represent how consumers engage with simulcasters today—much less how they likely will over the ensuing period. As SoundExchange demonstrated, through a proliferation of aggregator services like TuneIn and iHeartRadio, simulcasts allow consumers to lean in and exert more control over their listening experience. SX PFOF ¶¶ 899-918. As discussed in the next section, these aggregators such as allow users greater flexibility and choice, making it easier for users to find the music they want to hear.

941. These offerings are the result of the same forces that motivate convergence in the custom webcasting market. Just like custom services, simulcasters are looking to innovate and experiment and bring their product closer to what consumers want. iHeartRadio has improved its own simulcasting product by featuring its custom stations side-by-side with simulcast offerings, creating a seamless platform that encourages use of both interchangeably. Hr'g Tr. 4880:15-4881:24 (May 20, 2015) (Pittman). As internal documents show, iHeart is [redacted]

[redacted] Hr'g Ex. SX-2207 at 1. Lincoln Financial Media Company's [redacted] Hr'g Ex. SX-1579 at 7. Nothing suggests that such innovation will stop in the next rate period.

942. In a hypothetical negotiation, licensors would consider this innovation – and its likely progression – in assessing what a reasonable rate should be. And it would consider how simulcasters' offerings relate to offerings from other internet radio providers.

2. Licensors Would Not View Simulcasters As Identical To Terrestrial Broadcast Radio

943. NAB's arguments in favor of a discounted rate for simulcasters depend on the assumption that "simulcast" is identical to broadcast radio in every respect—in functionality, content, and promotional effect. NAB PFOF ¶¶ 3, 35-113. The evidence demonstrates that simulcast and terrestrial radio are different in key respects that undermine the NAB's central premise, and would directly affect what a licensor would agree to accept from simulcasters.

a. Simulcast's Rreach Is Not "Locally Based"—It Is National, If Not Global, In Scope.

944. The NAB repeatedly argues that simulcast is just like terrestrial in that it is "community focused and locally based." NAB PFOF ¶ 3. But the evidence demonstrates the contrary: listeners have access to scores of radio stations from all over the globe, as opposed to the handful of genre stations typically available in a particular geographical area. *See* SX PFOF ¶¶ 901-05. Broadcasters testified that their simulcasts can be heard from anywhere in the continental United States, with some allowing listening outside the U.S. *See* Hr'g Ex. NAB 4005 ¶ 22 (Downs WDT); Hr'g Ex. NAB 4002 ¶ 12 (Dimick WDT); Hr'g Tr. 5250:2-15 (May

21, 2015) (Downs); Hr'g Tr. 5845:5-17 (May 26, 2015) (Dimick). Prof. Katz confirmed that he lives in the Bay Area, but listens to simulcast stations from Texas, Los Angeles, France, and Germany. Hr'g Tr. 5757:6-13 (May 26, 2015) (Dimick).

945. Both Mr. Downs and Mr. Dimick testified that they could geo-fence their stations to limit the geographic reach of their simulcasts. Hr'g Tr. 5250:2-15 (May 21, 2015) (Downs); Hr'g Tr. 5845:18-5846:18 (May 26, 2015) (Dimick). They *choose* not to. As Mr. Dimick explained, availability outside of the local area is "kind of a service we like to offer" for their listeners. Hr'g Tr. 5846:5-11 (May 26, 2015) (Dimick).

946. NAB contends that this absence of geographic boundaries to simulcast does not matter, because NAB's members "generally are not interested in targeting" listeners outside of their own communities. NAB PFOF ¶ 45. The evidence of broadcaster behavior contradicts this characterization. Regardless of their professed interests, streams indisputably extend beyond their companion broadcast station's local areas. That broader geographic availability is a choice—is not something that simulcasters just have to accept as a consequence of streaming. Whether their interest is in "targeting" listeners who live in other markets or not, the effect of these choices is that simulcast services are available to a much broader audience than the "locally based" audience of the broadcast station, giving that broader audience more opportunity to find the music they want to listen to than ordinary broadcast radio.

947. NAB's own expert, Dr. Stephen Peterson, admitted that the lack of a geographic limitation on simulcast could alter a simulcast's promotional effects. Hr'g Tr. 3909:4-16 (May 14, 2015) (Peterson). He conceded that this difference raises the possibility that simulcast streams "could divert sales" because they "open[] up another opportunity" to listen to music. *Id.* at 3910:2-13. He conceded simulcast "would have to be studied," and acknowledged that he had

not performed any empirical analysis or study to determine whether simulcast and terrestrial radio result in different promotional effects. *Id.* at 3910:14-3911:2. In fact, Dr. Peterson admitted that he was not aware of any empirical analysis or study offered by any of the services on this issue. *Id.* at 3911:3-10.

948. Dr. Blackburn also testified that simulcast's increased search functionality over a greater geographic area would decrease the likelihood of a user going out and purchasing the music. Hr'g Tr. 1594:17-1596:20 (May 4, 2015) (Blackburn).

949. Mr. Wilcox from Warner echoed a similar view. Mr. Wilcox testified that because simulcast offers "almost an infinite number of choices of radio stations of every type and genre, subgenre, et cetera, all over the world that you can dial in to be streamed on your computer . . . there's much greater choice." Hr'g Tr. 2522:9-2523:9 (May 7, 2015) (Wilcox). This greater choice equates to "less chance" that simulcast will "inspire a purchase or consumption in an elective fashion." *Id.*

b. Simulcast Services Offer Greater Functionality Than Terrestrial Broadcast Radio

950. In addition to availability across a broad geographic area—affording a user access to a much wider set of options than typical broadcast stations—simulcasters offer greater functionality than is available on broadcast radio.

951. Users may search iHeartRadio and TuneIn for simulcast streams from a particular artist, genre, or geographical area. SX PFOF ¶¶ 906-18. This functionality is not available on terrestrial radio. Hr'g Ex. SX-29 ¶ 209 (Rubinfeld Corr. WRT); Hr'g Tr. 7076:7-12 (June 1, 2015) (Burruss). Dennis Kooker described an experiment that utilized this functionality. Hr'g Ex. SX-27 at 5 (Kooker WRT); Hr'g Tr. 6557:14-6558:9 (May 29, 2015) (Kooker). His search

identified where Meghan Trainor songs were currently playing at stations across the country, and played them from that station's stream. Hr'g Ex. SX-27 at 5 (Kooker WRT).

952. The search functions on iHeartRadio and TuneIn do not let the user identify a song and play it from the beginning. Rather, a user joins the song in progress. Hr'g Tr. 1596:21-1597:23 (May 4, 2015) (Blackburn); Hr'g Tr. 6559:18-6561:12 (May 29, 2015) (Kooker). The point is not that the search feature replicates an on-demand service, but that it allows users to user simulcast services differently than they use broadcast radio.

953. Through aggregators like TuneIn, simulcast users also have greater personalization and customization than broadcast radio. Mr. Dimick testified that TuneIn personalizes simulcast offerings to the user. Upon sign-on, TuneIn shows the listener a list of songs developed "over a period of time by telling TuneIn these are the songs that I like." Hr'g Tr. 5840:15-5851:7 (May 26, 2015) (Dimick).

954. The evidence also demonstrated that aggregators like iHeartRadio and TuneIn allow for more flexibility in user-interface controls beyond that permitted by terrestrial broadcast radio. Mr. Dimick acknowledged that TuneIn allows a user to pause, rewind, and record his station's simulcast stream. TuneIn's pause function actually pauses the stream and allows the user to re-start the stream where the user initially paused. Hr'g Tr. 5840:15-5851:7 (May 26, 2015) (Dimick).

955. Licensee services challenged whether the increased functionality available via aggregators replicated the experience on a more customized radio station, or whether it approached so-called "on-demand" functionality. But that is not the point, as Mr. Kooker testified. Hr'g Tr. 6645:5-15 (May 29, 2015) (Kooker). The point is that simulcast services offer these valued features, which distinguish them from terrestrial radio.

956. Simulcasters seek out these services and features in an effort to advance their product. Lincoln's availability through TuneIn is not by accident—it is by *agreement*. Mr. Dimick acknowledged that his company has an agreement with TuneIn to "provide them our stream" in exchange for a "share in the revenue" for certain advertising. Hr'g Tr. 5801:6-5802:25 (May 26, 2015) (Dimick). While Lincoln Financial remains responsible for the royalties, "[w]e feed them our stream, and they make it available to their consumer base." *Id.* at 5802: 19-25.

957. Numerous witnesses acknowledged that these differences *matter*. They dismantle the ultimate argument NAB advances: that simulcast and terrestrial are essentially the same, with the same promotional benefits and purportedly the same "negative" opportunity costs for record labels. *See* SX PFOF ¶¶ 901-13, 915, 919-21.

958. Record label witnesses also confirmed that the greater functionality of simulcast matters, because it renders "simulcast" not identical to terrestrial radio, as NAB contends. As Kooker explained:

> The ability to search *all* (or a selected portion) of iHeartRadio's simulcast stations in a musical genre or a geographic region and immediately identify and access specific artists and/or songs being played, or alternatively, search for a specific artist and immediately access that artist's music from various simulcast stations, make iHeart's simulcast service fundamentally different from terrestrial radio.

Hr'g Ex. SX-27 at 6 (Kooker WRT).

959. This view that terrestrial and simulcast offer different experiences that do not provide the same promotional effect is not one held only among lawyers in record companies' business affairs departments. The promotion departments agree. Mr. Burruss and Mr. Walk, two promotions executives for different record companies, both confirmed that they do not see

simulcast as offering the same experience for listeners or the same promotional opportunities for labels that terrestrial radio affords.

960. Mr. Burruss testified that, because listeners do not "engage [the same] way" with simulcast as they do with terrestrial radio, he believes that simulcast does not encourage its listeners to act upon their passion for listening in the same way as he believes terrestrial does. Hr'g Tr. 7082:3-22 (June 1, 2015) (Burruss). Mr. Burruss confirmed that his department does not measure listenership on simulcast in the same way it measures terrestrial listenership, or devote any of its resources to promotion on simulcast services. *Id.* at 7045:2-12, 7048:16-7050:15.

961. Mr. Walk's testimony is to the same effect. In Mr. Walk's words, "[s]imulcast is not a word that comes up in our promotion calls or meetings or conversations regarding the promotion of our acts." Hr'g Ex. IHM 3242 at 20 (Walk Dep. at 75:2-5).

3. NAB Has No Meaningful Response To The Broader Functionality For Simulcast That Aggregators Provide.

962. NAB does not dispute that aggregators like TuneIn and iHeartRadio provide for this broader search functionality and more flexibility in how a user listens. Nor does it dispute that simulcast streams are available outside of the broadcaster's local geographic area. Instead, it simply states that SoundExchange did not offer evidence "concerning the extent to which these functions were actually used, or their significance in the marketplace." NAB PFOF ¶ 74.

963. Again, that is not the right question. As explained at the beginning of this section, the relevant question is how the broader geographic availability and enhanced features—distinct from terrestrial radio—would affect the negotiation between a willing buyer and a willing seller. SoundExchange presented considerable evidence demonstrating that negotiators for record labels—some of the key sellers in the relevant hypothetical transaction—view the lack of

geographic boundaries and greater functionality available to simulcast listeners as significant to the question of what a simulcaster should pay for the right to perform sound recordings. *See* SX PFOF ¶¶ 899-918. That is the inquiry that matters here—not NAB's speculation about whether features are used.

964. And, just as a licensor would not consider the market static based on what options a service offers today, nor should the focus be on what features consumers are using today. The Judges are setting rates for the next five years—not the last five years. As Prof. Katz conceded, setting a lower rate for simulcast would discourage economically rational simulcasters from innovating. Hr'g Tr. 5743:5-5746:11 (May 26, 2015) (Katz). The focus should be on what the rate structure should be for simulcasters over the next five years, not what the simulcast market has been in the past.

965. In any event, the evidence demonstrates that aggregators like TuneIn are very popular among simulcast listeners, and is a sought-after platform for broadcasters. As John Dimick explained, TuneIn is "like . . . a one-stop shop. It's sort of where everybody goes to find out what's being streamed." Hr'g Tr. 5801:6-23 (May 26, 2015) (Dimick); *see also* Hr'g Ex. NAB 4009 ¶ 9 (Dimick WRT). iHeartRadio is also a popular aggregator of simulcast stations, as well as custom offerings. According to their own data, iHeartRadio has 50 million registered users (IHM PFOF ¶ 13 (citing Hr'g Ex. IHM 3222 ¶11 (Pittman WDT)). The Edison Infinite Dial study lists iHeartRadio as second in awareness (48% aware vs. 70% for Pandora). PAN Ex. 5289 at SNDEX0002875. iHeartRadio is also second to Pandora in the number of people over 12 who listened in the last month (9% vs. 31% for Pandora). *Id.* at SNDEX0002876. NAB's own expert, Prof. Katz, testified that he himself has taken advantage of the greater availability of simulcast stations absent geographic boundaries. Hr'g Tr. 5756:13-5757:13 (May 26, 2015)

(Katz). The prevalence of these aggregators would be considered by Licensors in analyzing what rate to apply to simulcasters.

B. NAB's Evidence Does Not Support The Conclusion That A Record Company Would Agree To Lower Rates For Simulcasters

966. The testimony and evidence NAB elicited and recites in its findings make clear that it believes its members should be able to deliver their content at no cost, regardless of whether it is delivered over-the-air or via the Internet. That is plainly not the law. *See* SoundExchange Reply Conclusions of Law, Section IV. This evidence does not go to the question at issue here: whether a willing seller would agree to discount the rate applicable to "simulcast" services. The relevant evidence in the record demonstrates that such a discount would not be a part of a willing buyer/willing seller agreement in the hypothetical market unencumbered by the statutory license.

1. The Relevant Marketplace Evidence Demonstrates That Licensors Would Not Agree To Discount Simulcast At The Rates NAB Is Proposing

a. The Available Marketplace Evidence Supports A Higher Rate For Simulcasting

967. NAB does not offer any marketplace evidence from which one could conclude that copyright owners would agree to license simulcasters at a lower rate than other webcasters. The actual market evidence makes clear that licensors would not license simulcast services at a lower rate. In particular, the iHeart-Warner agreement licenses [ ]. This is true regardless of whether NAB looks to expectations-based or performance-based analyses.

968. Mr. Wilcox testified to Warner's expectations regarding the [ ]: Warner "believed that it was likely that Warner's [ ]

[redacted] Hr'g Ex. SX-32 ¶ 8 (Wilcox WRT). This stands in contrast to the [redacted]. Hr'g Ex. SX-33 § 3(b)(i)-(ii). In one contemporaneous document, Warner [redacted]. Hr'g Ex. SX-91 at 4.

969. As a matter of actual performance [redacted] Hr'g Ex. SX-32 ¶ 9 (Wilcox WRT). Internal Warner documents show a rate as high as [redacted] as of March 2014 when Warner used payment to date to project forward over the entire agreement. *See* Hr'g Ex. SX-296 at 15 ([redacted]). Likewise, Prof. Rubinfeld calculated the effective average per-performance rates under the agreement and, for [redacted]. Hr'g Ex. SX-66. Accordingly, as an effective matter iHeart is paying [redacted].

b. No SoundExchange Witness Conceded That A Lower Rate Should Apply To "Simulcasters"

970. Instead of actual marketplace evidence, NAB points to testimony in which it contends that SoundExchange witnesses "conceded" that simulcasters should pay a lower rate. None of the three witnesses NAB relies on conceded that point.

971. First, NAB points to Dennis Kooker's written testimony, in which he states that the compulsory rates for statutory licensees exert downward pressure on privately negotiated rates. Mr. Kooker makes an observation about the legislative history underlying the statutory license: "One of the original justifications for allowing statutory services to pay these lower rates was that the offering under the statutory license would provide a user experience similar to terrestrial radio." Hr'g Ex. SX-12 at 16 (Kooker WDT). The NAB contends this amounts to a concession that simulcasters should pay lower rates, because it recognizes a "dichotomy" in functionality for "user experience" that is "similar to terrestrial radio." NAB PFOF ¶ 115.

972. NAB ignores the rest of Mr. Kooker's testimony. Mr. Kooker testified *at length* about simulcast, and made clear that he does not believe that it "provide[s] a user experience similar to terrestrial radio." Hr'g Ex. SX-12 at 16 (Kooker WDT). A significant portion of the experiments he conducted focused on iHeartRadio's aggregation of simulcast stations and the associated ability to find music playing on radio stations all over the world. As Mr. Kooker testified at the hearing:

> I think when you look at, in particular, the aggregation of simulcasts like you find in services like TuneIn or in the iHeart website [or] app, what you – what you have the ability to do is you have access to hundreds of terrestrial stations all at once, you have the ability to search for an artist or song, and you will instantly get results for that artist or song if they're playing somewhere in the massive network that's being aggregated and have the ability to play that song essentially on-demand.
>
> So, again, very unlike terrestrial radio where you would be listening to it in one single market and you would only be listening to what is actually programmed to play at that moment in time.

Hr'g Tr. 6556:13-6557:7 (May 29, 2015) (Kooker). The sentence NAB has pulled out of context is not about "simulcast" at all, much less a concession that simulcasters should pay a lower rate.

973. What is more, Mr. Kooker's testimony is not that there should be different rates for different functionality *within* the statutory license. Rather, the two rates Mr. Kooker described were the rate for the functionality permitted by the statutory license (which was conceived of as much more limited), and the rate for the functionality allowed in directly-licensed services. This testimony is not a "concession" that "simulcast" should obtain a lower rate.

974. Second, NAB repeatedly quotes the same portion of testimony from Aaron Harrison, in which he was asked to "rank" streaming services from "least substitutional to most." NAB PFOF ¶ 116. Mr. Harrison ranked "simulcast" as least substitutional, with "on demand" services at the other end of the spectrum. But Mr. Harrison clarified that by "simulcast" he was referring to something in particular: "The simulcast, as I understand it, which is playing the same broadcast on the Internet that's being played on terrestrial." Hr'g Tr. 1102:1-7 (Apr. 30, 2015) (Harrison). He was not asked about the various kinds of "simulcast" offerings in the market today—including those aggregated and enjoying the broader functionality offered through TuneIn and iHeartRadio. Nor did he offer any market examples of agreements with a simulcaster that yielded lower rates.

975. Finally, NAB points to Ray Hair's testimony, in particular with regard to comments filed on behalf of the unions in connection with the Copyright Office's recent music licensing study. In that document, the unions distinguished between, on the one hand, "plainly non-interactive, non-customized internet radio services that *work just like traditional over-the-air radio*," and more customized offerings. *Licensing Study Comments of SAG–AFTRA & AFM* at 5, *In re Music Licensing Study,* No. 2014-03 (May 23, 2014), available at http://copyright.gov/docs/musiclicensingstudy/comments/Docket2014_3/SAG_AFTRA_AFM_

MLS_2014.pdf. In the comments, the Artist's Unions expressed the view that "greater functionality of the customized services" should provide artists with "an enhanced or 'bumped up' rate for the increased value of greater functionality." *Id.* at 6.

976. The comments did not draw a distinction among services that employ some degree of customization and greater functionality. Rather, the distinction the unions drew was between internet radio services that "work just like traditional over-the-air radio" and other more customized offerings. But "simulcasters" do not "work just like traditional over the air radio." As detailed in Section VI.A., supra, services provide customization around simulcast that distinguishes it from services "just like traditional over-the-air radio." This is not a concession about the offerings NAB members testified about.

977. None of these witnesses "conceded" that "simulcasters" should be entitled to discounted rates. Nor does the available market evidence—more probative than hypotheticals presented in cross-examination—support such a result.

2. Prof. Katz's Theory Does Not Support A Rate Of "Near Zero"

978. In support of its proposed rate of near zero, NAB relies on Prof. Katz's testimony that prices in an "effectively competitive market . . . would be pushed towards the seller's marginal costs, including opportunity costs." NAB PFOF ¶ 214. Prof. Katz posits that, here, the seller's marginal costs are "effectively zero," and its opportunity costs are either zero or negative. *Id.* ¶ 198. Thus, he contends the applicable rate would be near zero. This is wrong.

979. Both Prof. Shapiro and Prof. Katz admit that sellers in this market would not price at or near marginal costs. As Prof. Katz acknowledges, in "[redacted]." Hr'g Ex. NAB 4000 ¶ 29 (Katz WDT). Prof. Shapiro also acknowledges that "[redacted]

[redacted] Hr'g Ex. PAN 5022 at 4 (Shapiro WDT). For goods like this, "[redacted]." *Id.* at 4-5; *see also* SX PFOF ¶¶ 496-500.[54]

980. Prof. Katz's arguments regarding near zero opportunity costs are also unfounded. First, he assumes that simulcast has the same promotional or substitutional effect as terrestrial radio. As SoundExchange illustrated in its Proposed Findings of Fact ¶¶ 897-921, and in Section VI.A., *supra*, the premise that "simulcast" and terrestrial radio share the same promotional and substitutional effects is contradicted by the testimony of multiple witnesses, including record company witnesses and NAB's own expert, Dr. Peterson. Dr. Peterson admitted that the effect of simulcast "would have to be studied," and acknowledged that he had not performed any empirical analysis or study to determine whether simulcast and terrestrial radio result in different promotional effects. Hr'g Tr. 3910:14-3911:2 (May 14, 2015) (Peterson). In fact, Dr. Peterson admitted that he was not aware of any empirical analysis or study offered by any of the services on this issue. *Id.* at 3911:3-10.

981. Next, Prof. Katz assumes that because record labels invest in the promotion of their music to terrestrial radio, simulcast has a net promotional effect and thus a negative opportunity cost. As SoundExchange explained in its Proposed Findings of Fact ¶¶ 879-85, NAB's reliance on terrestrial radio is misplaced. As Dr. Rubinfeld testified, because there is no market for performance rights on terrestrial radio, one cannot reliably glean from firm behavior

[54] SoundExchange detailed evidence of copyright owners' high fixed, recurring costs in its Proposed Findings. *See* SX PFOF ¶¶ 196-216 (record companies), ¶¶ 166-74 (recording artists).

in that non-existent market whether terrestrial radio has a net positive or net negative promotional effect. Hr'g Ex. SX-29 ¶¶ 7, 102-04 (Rubinfeld Corr. WRT).

982. Finally, NAB and Prof. Katz further assume that simulcasts draw listeners from terrestrial radio, creating a paid performance where none existed before. Again, NAB poses the wrong question. To determine what a record label's opportunity costs truly are, the question is not where are listeners coming from. The question is *where would those listeners go* if not for the availability of this simulcast alternative. If but for the availability of simulcast a listener would go to a higher ARPU, directly licensed service, then the opportunity cost is not negative; it is positive. *See supra* Section II.B.3.

983. NAB offers no proof that simulcast users are listening to simulcast instead of terrestrial. Indeed, iHeartMedia espoused precisely the opposite belief to sell record companies on the concept of direct licensing. Rather than taking listeners from terrestrial, iHeart's research revealed "Digital Is Incremental Listening," that is "In Addition To Not Instead of Broadcast Radio." Hr'g Ex. SX-196 at 5 (internal quotation marks omitted).

984. That assumption appears to be based on broadcaster testimony about who they intend their simulcast audience to be—not actual data reflecting a shift in listenership. In support of this point, NAB cites Prof. Katz (without evidence) and Mr. Newberry's statement that his company "want[s] to make it possible for our over-the-air listeners to hear our stations over the Internet, if that is what they want." NAB PFOF ¶ 204. But neither of these citations demonstrates that simulcast listeners are actually taken from terrestrial broadcasts. Indeed, both Mr. Downs and Mr. Dimick testified that they do not collect identifying data as to who is listening to their simulcast streams. Hr'g Tr. 5243:16-5245:7 (May 21, 2015) (Downs); Hr'g Tr. 5870:23-5871:9 (May 26, 2015) (Dimick). Since these simulcasters do not identify who is

listening to their streams, they could not know who is listening -- much less whether those listeners come from terrestrial broadcasts or not.

3. Terrestrial Radio's "Community Service" Is Irrelevant To Determining What Rate Should Apply For The Performance Of Sound Recordings

985. NAB describes numerous benefits that it contends terrestrial radio provides for its listeners. NAB PFOF ¶ 42-65. It cites testimony lauding the community benefits NAB contends follow from terrestrial radio's local focus, its "long tradition of community involvement," and its operation "in the public interest." *Id.* ¶¶ 42, 58. Again relying on its principal argument that terrestrial and simulcast are equivalent, the NAB claims that these reasons justify awarding simulcasters a lower rate than other webcasters. This is not marketplace evidence from which one could conclude that these purported benefits of terrestrial radio would prompt a record company to subsidize simulcast services by offering a lower rate. As a matter of law the policy considerations are inapplicable here. The question as a factual matter is would these public policy considerations affect a record company or licensor's decision to discount simulcasts in a willing buyer/willing seller transaction. The answer to that is plainly no.

986. NAB has pointed to no marketplace evidence in which a willing seller indicated that it was inclined to license simulcast at a lower rate in recognition of the community service efforts of local, broadcast radio stations. No marketplace evidence suggests that a record company or recording artist would agree to a lower rate for simulcasters because community members should be able to access news.

987. To the contrary, the evidence shows that licensors do not believe that a discount for terrestrial radio is warranted. Witnesses testified that they believe that terrestrial radio broadcasters already obtain an "unfortunate" and "unfair" advantage because they can play sound recordings without any royalty obligation. SX PFOF ¶¶882-84; Hr'g Tr. 1371:25-1372:13

(May 1, 2015) (Harleston); Hr'g Tr. 7057:10-19 (June 1, 2015) (Burruss). Jeff Harleston of Universal Music Group was asked about the benefit to Universal Music Group from the plays on terrestrial radio of the Robin Thicke song, "Blurred Lines." Mr. Harleston testified that, "[u]nfortunately, the copyright law does not provide for a performance right in terrestrial sound recordings," and that, "[t]he benefit to Universal from the terrestrial airplay was, unfortunately, only promotional because the copyright law does not provide for terrestrial radio to play it – to pay a performance royalty." Hr'g Tr. 1371:25-1372:13 (May 1, 2015) (Harleston).

988. Similarly, Jim Burruss, Senior Vice President of Promotion Operations for Columbia Records, testified that he believed it was "unfair" that artists and labels were not compensated for airplay on terrestrial radio, stating that he "would like to see our artists and our labels get paid for what's right." Hr'g Tr. 7057:10-19 (June 1, 2015) (Burruss).

989. In the Comments to the Music Licensing Study the NAB relies on in their findings, the unions for recording artists characterized the absence of a terrestrial performance right as "[t]he single most fundamental platform parity issue facing Artists today":

> While all other music platforms compensate Artists and copyright owners for the public performance of their sound recordings, broadcast radio continues to enjoy an unfair competitive advantage under federal law. Moreover, for more than seventy years, this loophole in our laws has deprived Artists of fair compensation for the exploitation of their sound recordings on terrestrial radio in the United States. And, as the Copyright Office has frequently pointed out (most recently in footnote 14 of the NOI), the absence of the terrestrial public performance right in the U.S. prevents Artists from collecting millions of dollars of foreign public performance royalties, and puts the United States in the unlikely company of China, North Korea and Iran. The Artists' Unions have been at the forefront of efforts to amend the law to provide a full public performance right in sound recordings ever since sound recordings were granted federal copyright protection. Radio has built a $15 billion industry based primarily on the exploitation of the creative work of Artists, and should finally be required to fairly compensate those Artists.

Licensing Study Comments of SAG–AFTRA & AFM at 6, *In re Music Licensing Study,* No. 2014-03 (May 23, 2014), available at http://copyright.gov/docs/musiclicensingstudy/comments/Docket2014_3/SAG_AFTRA_AFM_MLS_2014.pdf
55

990. No evidence indicated that licensors believe the absence of a royalty (or a discounted royalty) is justified in light of what NAB claims is terrestrial radio's "special" status, so the notion that a willing licensor would agree to such a discount for simulcast is baseless. NAB does not tie its "local focus" or "community service" arguments to the statutory standard. Rather, these arguments are referenced in the NAB's Conclusions of Law, in a lengthy section devoted to why NAB contends Congress did not extend the performance right to terrestrial broadcasters. NAB COL ¶ 673. SoundExchange refutes this legal argument in its Reply Conclusions of Law.

991. In any event, whatever local focus terrestrial radio may have, simulcast is different. Simulcast is geographically unbound, unlike terrestrial radio. The "local focus" arguments are simply inapplicable to simulcast, because simulcasters make their streams available without geographic boundaries.

4. Terrestrial Radio's "Non-Music" Content Should Not Reduce The Rate Applicable To Music Content

992. NAB also points to its members' stations' on-air personalities and other non-music content, including news, sports and weather. *See ,e.g.*, NAB PFOF ¶¶ 400-405. The mere fact that simulcasters include content that does *not* implicate the performance right should not drive down the rate for the performance right.

[55] NAB contends that these comments are public record, and the Judges may take official notice of their content. NAB PFOF ¶ 117 n.2.

993. The rate structure that SoundExchange has proposed would account for non-music content simply and effectively. The per-play prong of the rate proposal would only require royalty payments per performance of a sound recording— not for non-music content. And the proposed revenue share (discussed further in Section III.D.3, *supra*) requires only that Services provide a fair allocation. Under this rate structure, there is no reason to discount a rate because of the presence of non-music content. If revenue may be fairly allocated to exclude non-music content, then the issue of non-music content is encompassed within SoundExchange's rate proposal.

C. The NAB's Proposal To Segment Rates For Simulcasters Should Be Rejected As Unsound

994. A segmented rate would be bad for the webcasting market. *See* SX PFOF ¶¶ 930-38. If a statutory license offered a discounted rate for less-than-total DMCA functionality, that would discourage simulcasters' innovation efforts. Music users would be incentivized to limit their uses of music to that specified functionality, rather than developing and innovating their services to meet consumer demand. *See* Hr'g Ex. SX-29 ¶ 211 (Rubinfeld Corr. WRT). Prof. Katz conceded that a segmented statutory rate would create such incentives and disincentives, potentially deterring innovation:

> Q: Now, if a lower rate applied to simulcasters than to nonsimulcasters, that might create certain incentives and disincentives for simulcasters, correct?
>
> A: In theory, yes.
>
> Q: If innovating the simulcast service would result in having to pay a higher rate, an economically rational simulcaster would take that higher rate into account before deciding whether to innovate, correct?
>
> A: If such an innovation existed, if you were rational, you would take that into account, yes.

Hr'g Tr. 5745:24-5746:11 (May 26, 2015) (Katz).

995. A rate segmented based on functionality would invite gamesmanship in an effort to obtain particular royalty treatment. [redacted] If simulcasters were subject to a distinct rate, other webcasters would inevitably attempt similar tactics to reduce their royalty obligations." Hr'g Ex. SX-29 ¶ 211 (Rubinfeld Corr. WRT).

996. NAB's PFOF argues for a different rate for simulcasters versus more customized offerings, but neither NAB nor any other party actually offered evidence that such segmentation would be economically feasible. No party has offered any evidence of any ability to identify those users who are inclined to use simulcast and nothing more. NAB offered no evidence that demand elasticities are different among distinct segments of services, or that different types of users would listen to a simulcast over a different webcasting service. Such evidence would be "essential if the CRB were to set different rates for different commercial segments." Hr'g Ex. SX-29 ¶ 208 (Rubinfeld Corr. WRT).

997. Without the ability to clearly identify a market segment for simulcast listeners, price discrimination is likely to sweep in users who would have paid more. Because there is no way to effectively segment the population into simulcast listeners and non-simulcast listeners, segmented rates would unfairly advantage simulcasters.

998. Setting a lower rate for "simulcast" would create a subsidy for a business model NAB's members' testimony demonstrates is, at present, inefficient. *See supra* Section ¶¶ 206-215. At present, despite what they contend are "confiscatory" rates, NAB members are making the choice to stream. And they are aligning with aggregators like TuneIn and iHeartRadio who are adding to the consumer experience of simulcast. *See supra* Section VI.A.3. If a lower rate is

imposed for a service defined as a "simulcast" in the regulations, it will amount to a thumb on the scale favoring a particular business model over others. Simulcasters would shut down efforts to innovate towards customer preference in favor of staying within a prescribed statutory definition in order to maintain a lower rate.

999. The definition itself setting the degree of functionality to be covered by a segmented rate would be very difficult to define and enforce. NAB has not offered any way to limit the "simulcast" definition to only those streams that are identical to the over-the-air broadcast—"replicated" (in the words of Prof. Katz). Without the ability to do that, NAB's arguments for a segmented rate structure collapse.

1000. Even among the parties' proposed definitions here, the variation between what would constitute a "Broadcast Retransmission" and what would fall outside of that definition is broad. Acknowledging that their prior definition of "Broadcast Retransmission" allowed deviation from the over-the-air broadcast, the NAB has now amended their proposed to attempt to close the loophole it previously left open. NAB's proposed definition initially allowed for a stream to remain a "Broadcast Retransmission" for rate purposes, even when the stream included the "occasional substitution of other programming that does not change the character of the content of the transmission." *NAB's Proposed Rates and Terms* at 2 (Oct. 7, 2014). The new definition deletes this sentence, and adds a sentence stating: "Broadcast Retransmissions do not include transmissions in which the sound recordings that are performed are customized to a user." NAB PFOF ¶¶ 609-11.

1001. This proposed definition still allows for deviation from the terrestrial broadcast. Now, Broadcast Retransmissions are "*primarily* retransmissions of terrestrial over-the-air broadcast programming." *NAB's Amended Proposed Rates and Terms* at 2 (emphasis added).

The use of the word "primarily" allows deviation from what NAB claims simulcast is: an exact replication of the terrestrial over-the-air broadcast. The definition still provides that the simulcast stream may substitute out advertising content, and content that has not been approved for simulcast streaming. And simulcasters may further swap out for directly licensed sound recordings without losing their "Broadcast Retransmission" status. This host of permissible deviations is not consistent with NAB's constant refrain that "simulcast" means the exact same stream, delivered in a different way.

1002. NAB's alterations to its own definition do nothing to change the proposed definition proffered by iHeartRadio, which would allow even broader shifts in the content being streamed than would NAB's definition. iHeart's definition of "Broadcast Retransmission" still would allow up to 49.9% of the content to be swapped out of the terrestrial stream [redacted] while still allowing iHeartMedia to treat the stream as a "Broadcast Retransmission" for rate purposes:

> For the further avoidance of doubt, a Broadcast Retransmission does not cease to be a Broadcast Retransmission because the Broadcaster has replaced programming in its retransmission of the radio broadcast, so long as a majority of the programming in any given hour of the radio broadcast has not been replaced.

1003. *Proposed Rates and Terms of iHeartMedia, Inc.* ¶ 2 (Oct. 7, 2014). NAB's core argument for a lower rate is its refrain that a "simulcast" comprises precisely the same content that airs on terrestrial radio—but neither NAB nor iHeart have proposed definitions that would actually require that.

D. NAB's "Previously Unavailable Evidence" Does Not Undermine the Judges' Reliance on NAB WSA Agreement as Benchmark in Web III

1004. To set the statutory rates for commercial webcasters in the last proceeding, the Judges relied, in part, upon a WSA agreement reached between NAB and SoundExchange in

2009 (and submitted to the Judges as a settlement for all commercial broadcasters for 2011-2015). Before doing so, the Judges thoroughly analyzed the suitability of the settlement as a benchmark. *Web III Remand*, 79 Fed. Reg. at 23111-23114; *accord Web III Final Order*, 76 Fed. Reg. at 13035, *vacated on other grounds* ("After careful consideration of the evidence presented on the various suggested sources of potential overvaluation and undervaluation of the market rates by the NAB-SoundExchange and SiriusXM agreements, we find that the rates in these agreements do not appear to seriously overvalue or undervalue input prices likely to prevail in the market.").

1005. NAB now attempts to show that the Judges were wrong to conclude that NAB WSA agreement was a probative benchmark for those proceedings by pointing the Judges to "evidence not previously available." NAB PFOF ¶ 285. None of this purported "new evidence" affects the Judges' prior analysis or conclusion. As SoundExchange showed in its Proposed Findings of Fact—and as NAB itself told the Judges in 2009—NAB's WSA agreement was a "manifestly . . . reasonable basis for setting statutory terms and rates." Hr'g Ex. SX-122 at 4 (NAB-SoundExchange "Joint Motion To Adopt Partial Settlement"); *see* SX PFOF ¶¶ 1034-1070.

1. NAB's Premise That It Had "No Meaningful Alternative" To Negotiating With SoundExchange Is Demonstrably False

1006. NAB's attempt to disavow its voluntarily negotiated WSA agreement rests on the premise that the agreement was a "take-it-or-leave-it result between a monopoly seller that held all of the cards and a buyer that had no viable alternatives." Hr'g Ex. NAB 4001 ¶ 3 (Newberry WDT); *see also* NAB PFOF ¶ 249. NAB's rhetoric does not match up with reality: the facts show that it had a host of meaningful alternatives to negotiating with SoundExchange. SX PFOF ¶¶ 1047-1054.

a. Statutory Rate-Setting Proceeding Was A Manifestly Meaningful Option Available To Both Parties

1007. Most fundamentally, as the Judges emphasized in *Web III*, NAB "could have chosen instead to be subject to the rates to be set by the Judges." *Web III Remand*, 79 Fed. Reg. at 23114; *accord Web III Final Order*, 76 Fed. Reg. at 13034, *vacated on other grounds*. Nothing NAB says now changes this basic fact. NAB's dissatisfaction with *Web II* and its prospects in *Web III* in no way make the always-available option of Judge-set WBWS rates a less than meaningful option. At the time of the negotiation, while neither party yet knew where the statutory rates for 2011-2015 would fall, both certainly knew that the Judges would soon be setting the rates based on marketplace evidence of the rates that would be negotiated by willing buyers and willing sellers in the hypothetical market. Such market-based, Judge-set statutory rates were a manifestly "meaningful alternative" available to both parties. *Contra* NAB PFOF ¶ 249. NAB does not—and cannot—suggest that either party was compelled by the WSA—or anything else—to negotiate a settlement. Both parties voluntarily elected to do so. Neither would have made that choice if it thought the settlement's rates diverged materially from the WBWS rates that would be set by the Judges. *Web III Remand*, 79 Fed. Reg. at 23114. In short, NAB's argument rests on a fundamentally irrational assumption: that it willingly agreed to pay above-market rates rather than avail itself of the market-based rates that were going to be set in *Web III*. *Id.*

1008. The most that can be gleaned from NAB's "new evidence" is that it would have preferred that market rates be lower, or that the marketplace evidence look differently than it did. By Mr. Newberry's own admission, NAB's pessimism about *Web III* derived from the simple fact that marketplace evidence did not support the "case [NAB] wanted to pursue." Hr'g Tr. 5117:20-25 (May 20, 2015) (Newberry). But the unsurprising fact that NAB would have

preferred to pay lower rates certainly does not mean that NAB's negotiation with SoundExchange was anything other than voluntary, or that its voluntarily negotiated settlement—a settlement that NAB itself previously told the Judges was a "reasonable basis for setting statutory terms and rates"—was anything other than a "reasonable basis for setting statutory terms and rates" in *Web III*. Hr'g Ex. SX-122 at 4.

b. NAB Mischaracterizes Viability Of Direct Licensing

1009. NAB also disputes that negotiating licenses directly with labels was ever a real option. NAB PFOF ¶¶ 258-266. First, it wrongly suggests that direct licensing was not permitted because the WSA only granted negotiating authority to "the receiving agent," i.e., SoundExchange. NAB PFOF ¶ 258. Congress's grant of special negotiating authority to SoundExchange in the WSA is entirely irrelevant. The WSA did nothing to disturb licensees' ever-present option to negotiate directly with copyright owners. 17 U.S.C. 114 § (f)(3). Statutory licensees' ability to negotiate with labels is no way related to or contingent on the WSA.

1010. NAB also claims that direct negotiations were not an option simply because no statutory service had yet negotiated a direct license. NAB PFOF ¶ 259. Even if this were the case, it would in no way suggest that direct licensing was not an available option. The lack of direct licensing instead implies only that: (i) the statutory rate never exceeded market rates, so labels never would have had any incentive to agree to renegotiate; and (ii) the collective negotiation framework facilitated by the WSA was a more convenient vehicle for reaching alternative solutions. Hr'g Ex. SX-17 ¶ 90 (Rubinfeld Corr. WDT) ("[I]f the statutory rate is too high—i.e., exceeds the 'market rates' that would be voluntarily negotiated between willing parties in the absence of the statutory license—then licensees and licensors have a joint incentive to renegotiate."); Hr'g Tr. 7577:1-7 (June 3, 2015) (Huppe) ("It is obviously more convenient for

a service or licensee to negotiate with one entity for all the rights. That's part of what Congress had in mind when they set up the statutory license. But it is absolutely the case that broadcasters could go directly to rights owners.").

1011. NAB's claim that labels would have been unwilling to engage in direct negotiations because doing so would "undercut SoundExchange's collective strategy" does not withstand scrutiny. NAB PFOF ¶ 260. As an initial matter, NAB's argument seems to mistakenly assume that a label's direct license negotiations would necessarily overlap with SoundExchange's WSA settlement negotiations. Hr'g Tr. 5784:10-14 (May 26, 2015) (Katz). NAB could have pursued direct licenses with any or all copyright owners at any point in the last seven years; it was in no way limited to the WSA's negotiating window. SX PFOF ¶ 1047. In any event, if an individual label at any time thought a direct license was in its best interest, there is nothing in the record to suggest that its SoundExchange membership or participation on the SoundExchange Board or Licensing Committee would prevent the label from pursuing the direct license. Warner occupied the same position on the SoundExchange Board and Licensing Committee when it entered into a direct license with iHeart as it did in 2009. Hr'g Ex. SX-11 ¶ 6 (Huppe WDT); Hr'g Tr. 5783:22-5784:17 (May 26, 2015) (Katz). Similarly, Mr. Van Arman's SoundExchange board membership and participation on the Licensing Committee did not stand in the way of Merlin doing a direct deal or stop his own label from opting-in to that deal. Hr'g Tr. 730:2-13 (April 29, 2015) (Huppe); Hr'g Ex. SX-20 at 2 (Van Arman WDT); Hr'g Ex. SX-30 at 2 (Van Arman WRT).

1012. Finally, NAB's insinuation that SoundExchange affirmatively discourages direct licensing is not supported by the evidence. NAB PFOF ¶¶ 262-266. NAB points to events surrounding Sirius XM's direct licensing efforts in 2011 as support for the notion that

SoundExchange somehow obstructs direct deals. Specifically, it suggests that two public statements issued by SoundExchange in 2011 were designed to "discourage record labels from signing direct deals" with Sirius XM. NAB PFOF ¶¶ 263-264. Without any factual basis, NAB also tries to attribute three artist organizations' public statements about Sirius XM's initiative to SoundExchange—statements that it suggests were improper because they "called on artists to discourage their labels from entering into direct deals" with Sirius XM. NAB PFOF ¶¶ 265-266; Hr'g Tr. 7611:16-7618:14 (June 3, 2015) (Huppe).

1013. NAB's misleading telling of the events surrounding Sirius XM's direct licensing initiative omits several critical contextual facts. First, most importantly, "the whole industry was worked up" and concerned by the Sirius XM initiative, not because Sirius XM was negotiating direct licenses, but because Sirius XM had adopted objectionable tactics to do so. Hr'g Tr. 7620:5-9 (June 3, 2015) (Huppe). Specifically, the industry—and the artist community in particular—was concerned because Sirius XM was trying to entice labels to do direct deals by offering them the share of royalties that would go to artists under the statutory license. As Mr. Huppe explained at the hearing:

> One of the biggest things going on here had to do with artists' direct pay. . . . [W]hen a service uses the statutory license and they pay through SoundExchange, SoundExchange sends 50 percent of all royalties directly to the artist. And part of the reason why the artist groups . . . were particularly agitated about [the Sirius XM licensing initiative] is because it was an outright attempt to basically claw that back and have 100 percent of the royalties go to the rights owner. . . . That is why this had become such a huge, huge bubbling issue, especially for the artist community. That's why – you know, it's not at all surprising that there was tumult in the industry going on at the time because it was viewed as a grab at the artist money.

Hr'g Tr. 7623:3-25 (June 3, 2015) (Huppe).

1014. Second, NAB misconstrues the nature of the public statements SoundExchange made regarding Sirius XM's direct licensing initiative. Mr. Huppe testified that SoundExchange was being inundated with questions from its members at the time, questions that "made it clear that there was a striking lack of information" about SoundExchange, the rate-setting proceedings, and how the statutory license works. Hr'g Tr. 7606:14-7611:12 (June 3, 2015) (Huppe). SoundExchange issued public statements to respond to these inquiries and to stem what appeared to be widespread confusion. As Mr. Huppe testified, SoundExchange "sought to inform everyone of the facts regarding the circumstances that were [] occurring at that time." *Id.* Indeed, it is SoundExchange's "obligation to inform the people that [it] represent[s] about the facts surrounding the *Web III* case and the facts surrounding this entire area of the industry." Hr'g Tr. 7606:21-7607:3 (June 3, 2015) (Huppe). In light of SoundExchange's mission and purpose, it would have been irresponsible to ignore its members inquiries and silently sanction misinformation. *Id.*; *see also, e.g.*, Hr'g Ex. SX-11 ¶ 2 (Huppe WDT) ("[I]t is important to us that rightsholders, artists, and musicians understand our work, and understand the rights that we administer on their behalf."). In responding to its members inquiries, therefore, SoundExchange was motivated by a desire to ensure that labels' licensing decisions were "fully informed," not a desire to compel any particular result:

> It's always up to every individual company and rights owner to do whatever is in their best interest. Any time we ever talk about this issue, we start and end, and I certainly start and end, in every conversation, with the fact that people should do what's in their own interest. Companies should do what's in their best interest. We're just here doing our job, informing them of the facts.

Hr'g Tr. 7607:13-25 (June 3, 2015) (Huppe).

1015. There is simply no factual basis for NAB's insinuations. SoundExchange does not discourage but instead actively facilitates direct licensing by agreeing to administer direct deals:

> Our view is if the market moves [towards direct licensing], if we can help things flow more efficiently, if we can help the data be correct, help the money flow accurately and quickly and including paying the artists their share directly, it's something we're willing to do. So we recognize the direct licensing as part of the ecosystem. We just want to make sure that when people choose to enter [direct licenses] they do so with full information.

Hr'g Tr. 7640:18-7641:16 (June 3, 2015) (Huppe).

2. NAB Possessed Countervailing Bargaining Power

1016. The Judges also rightfully recognized in *Web III* that any leverage SoundExchange might have had in the negotiations would have been counterbalanced by NAB's "countervailing market power." *Web III Remand* at 23114; *accord Web III Final Order*, 76 Fed. Reg. at 13034, *vacated on other grounds* ("NAB, which negotiated on behalf of broadcasters, effectively served as a single buyer and, thus, may be said to have exercised countervailing market power relative to SoundExchange."). NAB has failed to offer any evidence that disturbs the Judges' prior conclusion. Its attempt to disclaim its buyer-side bargaining power falls flat. NAB PFOF ¶ 249. NAB cannot deny that, as a factual matter, it represented a multi-billion-dollar industry, "accounted for over 50% of the [webcasting] royalty payments to SoundExchange" at the time, and could threaten to walk away from streaming altogether (unlike SoundExchange, which could not make the "no license" threat). SX PFOF ¶¶ 1053, 1055-57; *Web III Remand*, 79 Fed. Reg. at 23314 (citing Ordover WRT). And Prof. Talley debunked Prof. Katz's theorizing that these factors could not have given NAB meaningful leverage in the negotiation. SX PFOF ¶ 1056.

3. Shadow Of Statutory Rates Did Not Extend To Rates Negotiated For 2011-2015

1017. NAB's argument that *Web II* "infected" the results of the negotiations dramatically overstates the shadow cast by the *Web II* rates. NAB PFOF ¶¶ 267-268. As a matter of simple timing, the WSA negotiations were driven by uncertainty over the rates that would be set in *Web III* and govern the 2011-2015 term, not the remaining two years covered by *Web II*. SX PFOF ¶¶ 1037-1042.

4. NAB Agreed That Its Settlement Should Be Used To Set Statutory Rates in Web III

1018. Finally, the fact that the parties agreed that the agreement should be precedential in no way undermines its probative value as a benchmark in *Web III*. NAB PFOF ¶¶ 268-275. Reliance on a settlement that the parties jointly designated as precedential and jointly submitted to the Judges, asking that its rates and terms be adopted for entire category of statutory licensees, is natural and appropriate. SX PFOF ¶¶ 1061-1070.

1019. As an initial matter, it is important to recognize that SoundExchange did not have the unilateral ability to designate (or not designate) WSA settlements as precedential, notwithstanding NAB's insinuations to the contrary. NAB PFOF ¶¶ 270-271. And in this case, NAB not only agreed that its settlement should be precedential, but it also filed a Joint Brief expressly asking that its settlement be used to set rates for all broadcasters, even those that did not opt in to the WSA settlement. Hr'g Ex. SX-122. NAB's contemporaneous view of its settlement, as expressed in a filing to the Judges, is far more credible than its self-serving, post-hoc attempt to explain away its significance.

1020. NAB is also wrong to suggest that the fact that only certain WSA agreements are precedential is indicative of an improper "selection bias." NAB PFOF ¶¶ 270-271. As

SoundExchange explained in its Proposed Findings of Fact, that some WSA settlements are precedential but most are not is precisely as Congress intended. SX PFOF ¶¶ 1067-1070.

1021. Finally, NAB's claim that the agreement's precedential nature skewed incentives in SoundExchange's favor defies common sense. NAB PFOF ¶¶ 268, 271. The fact that the agreement was going to be precedential gave both parties the incentive to ensure that the agreement reflected fair market rates. Licensees have the very same interest as SoundExchange in this regard because a service's precedential settlement, by definition, could be used against the same service in the future. By attempting to disavow its WSA settlement, NAB is demonstrating its keen interest in the agreement's precedential value in these very proceedings.

VII. SIRIUSXM'S RATE PROPOSAL IS ARBITRARY AND UNREASONABLE

A. Sirius XM's Voluntarily Negotiated 2009 WSA Settlement Was Informative Of WBWS Rates In Web III, And Sirius XM's Belated Attempt To Disavow It Fails

1022. Much like NAB, Sirius XM has tried to undermine the Judges' reliance on its 2009 WSA Settlement in *Web III*. As SoundExchange detailed at length in its Proposed Findings of Fact, Sirius XM's attempt to suggest that its settlement contained above-market rates fails for the simple reason that Sirius XM voluntarily agreed to the rates even though it was under no compulsion to negotiate with SoundExchange. *See* SX PFOF Section XII, ¶¶ 1071-1081. Given the other options available to Sirius XM at the time, as a matter of common sense, Sirius XM would have rejected the SoundExchange settlement if it contained unreasonable rates.

1023. In its proposed findings, Sirius XM largely retreads the same ground as Mr. Frear's written direct testimony on this issue. SXM PFOF ¶¶ 38-63 It also attempts to respond to Mr. Huppe's testimony regarding the context of SoundExchange's negotiations with Sirius XM. But Sirius XM's response to Mr. Huppe does little more than demonstrate the unremarkable fact that, of the various options available to Sirius XM at the time, it felt that

negotiating with SoundExchange was the best option. But this in no way diminishes the probative value of the agreement; if anything, it bolsters it. Sirius XM willingly agreed to the WSA Settlement because it felt it was a good option, not because a settlement with SoundExchange was the only means by which to obtain a license.

1024. Voluntarily negotiated settlements "allow each side to compromise, claim a measure of victory, and go home." 155 Cong. Rec. H6331 (statement of Rep. Brown) (June 9, 2009). The WSA settlement with Sirius XM was no different. At bottom, Sirius XM's complaint seems to be that it did not get everything it wanted in its negotiation with SoundExchange. But SoundExchange did not get everything it wanted either. That Sirius XM might have preferred lower rates does not mean that the negotiated compromise it reached with SoundExchange is not probative evidence of the rates to which willing buyers and willing sellers would agree in the hypothetical market.

1025. In addition to relying on an argument that suffers from fundamental logical flaws, in advancing its illogical argument, Sirius XM continues to mischaracterize the circumstances surrounding the negotiation of its 2009 WSA Settlement.

1026. As an initial matter, Sirius XM suggests that Congress passed the WSA because *Web II* had set "wildly supracompetitive" rates. SXM PFOF ¶ 52. Congress said no such thing; in fact, it said the opposite:

> The recent government rate was determined on March 2, 2007. After considering voluminous written submissions and 48 days of trial testimony that filled 13,288 pages of transcript, the Copyright Royalty Judges determined *fair, marketplace-based rates*, averaged over a 5-year rate period. . . Neither this deal nor this bill should be understood as a criticism of the judges' decision, and I would expect marketplace rates to be higher and at least a reflection of what the judges decided absent the distinct circumstances that apply here.

154 Cong. Rec. H10278 (Statement of Rep. Howard Berman) (Sept. 27, 2008) (emphasis added); *see also, e.g.* 154 Cong. Rec. H10278 (Statement of Rep. Smith) (Sept. 27, 2008) ("In issuing its final ruling, the CRB established the *market rates and terms* . . ." (emphasis added).

1027. Second, Sirius XM is flatly wrong to suggest that its negotiation with SoundExchange did not "mov[e] the needle with respect to royalty rates." SXM PFOF ¶ 51. Sirius XM was not only able to negotiate rate lower than the then-prevailing statutory rates for 2009, 2010, and 2011, but it was also able to negotiate lower rates for 2013, 2014, and 2015 than were contained in the NAB settlement. SX PFOF ¶ 1079.

1028. Similarly, Sirius XM's suggestion that SoundExchange made a tactical, "last-minute demand" that the agreement be precedential distorts the nature of the negotiation. SXM PFOF ¶ 63. Sirius XM voluntarily agreed that the agreement should be precedential; nothing compelled it do so. SX PFOF ¶ 1080. Moreover, Mr. Huppe believed the parties had a shared assumption throughout the negotiation that any agreement they reached would be precedential. SoundExchange did not try to spring the a precedential provision on Sirius XM late in the negotiation as a tactical maneuver; it simply raised it at the end of the negotiation because it "presumed it wouldn't be a big deal to make [the agreement] precedential." Hr'g Tr. 7628:19-25 (June 3, 2015) (Huppe). And, by Mr. Frear's own admission, he in fact did not regard it as a big deal at the time. Hr'g Tr. 5444:18-5445:1 (May 22, 2015) (Frear). When Mr. Huppe confirmed that SoundExchange wanted Sirius XM to agree that the settlement may be precedential, [redacted]. NAB Ex. 4235.

1029. In response to the irrefutable point that Sirius XM could have availed itself of the WBWS rates that were going to be established in the next rate-setting proceeding as an alternative to settling with SoundExchange, Sirius XM suggests that refusing the settlement and

relying on *Web III* was not a viable option because Sirius XM would have lost out on royalty relief in 2009 and 2010 if it had done so. SXM PFOF ¶ 59. This argument appears to be fundamentally confused. Sirius XM's settlement covered seven years, and its principal complaint now is with the rates for the years that overlapped with rates set in *Web III* (2011-2015). If the rates in the settlement with SoundExchange for 2011-2015 were unreasonable and above-market rates, as Sirius XM now asserts, the cost-saving course would have been to reject the settlement and wait to rely on the market-based rates the Judges would set for 2011-2015. This reason is simple: the *two years* of royalty savings would have been outweighed by *five years* of above-market rates. But rather than wait to see what rates would be set by the Judges, Sirius XM voluntarily agreed to settle with SoundExchange. Sirius XM's response that a wait-and-see approach "obviously would have resulted in higher net costs" for Sirius XM only makes sense if Sirius XM believed at the time that its settlement with SoundExchange contained market (or below-market) rates for 2011-2015. SXM PFOF ¶ 59. If it instead thought the rates it had negotiated with SoundExchange for 2011-2015 were above market rates, availing itself of the market rates that were going to be set in *Web III* would have been the cost-saving option.

1030. Sirius XM mischaracterizes the viability of the direct licensing option in much the same way as NAB. *See* Section VI. D.1.b, *supra*. Like NAB, it wrongly suggests that direct negotiations would have had to be completed within the short time frame allowed for by the WSA. SXM PFOF ¶ 55. There is simply no reason to think negotiations with labels would have needed to be on this time frame. The WSA had no impact whatsoever on the direct-licensing option that is always available to services. And Sirius XM's hyperbolic claim that obtaining direct licenses for all the music Sirius XM plays is a "logistical impossibility" ignores that hundreds of digital services that do not rely on the statutory license have been able to

accomplish the feat. SXM PFOF ¶ 55; *see* Hr'g Ex. SX-9 ¶ 32 (Harleston WDT). Finally, Sirius XM's claim that SoundExchange would have prevented it from pursuing direct licenses relies on an abbreviated and misleading characterization of the events that transpired around its 2011 direct licensing initiative. SXM PFOF ¶ 56; *see supra* Section VI. D.1.b.

B. Sirius XM's Benchmark Analysis Fails To Support Its Rate Proposal

1031. SoundExchange noted the arbitrary and unreasonable nature of Sirius XM's rate proposal in its Proposed Findings of Fact. SX PFOF ¶ 1081. Sirius XM has done nothing to remedy the failings of its thin benchmark analysis in its proposed findings. SXM PFOF ¶¶ 64-68. Sirius XM's rate proposal continues to lack any sound justification: it is still bafflingly derived from an agreement that it purports to be an unreliable benchmark. SXM PFOF ¶ 64. In the very same sentence that Sirius XM argues that its 2009 WSA agreement is not a "reliable benchmark," it adopts the very same agreement as the sole "marketplace referent" for its rate proposal. *Id.* This contradictory, self-defeating analysis cannot be a reliable foundation for a rate proposal.

1032. Moreover, Sirius XM's benchmark analysis of its WSA agreement is erroneous and improper. It does little more than pluck out the rate for the first year covered by its settlement, asserting that "only the lowest rate contained [in] the agreement should be considered." SXM PFOF ¶ 64. Sirius XM has no basis for its selective reliance on just one year of a seven-year agreement beyond its meritless, illogical complaint that it voluntarily agreed to above-market rates for the remaining years. Its acontextual, isolated reliance on the first year of the agreement is entirely inappropriate.

1033. As an initial matter, Sirius XM's proposal ignores the rapidly-changing nature of the streaming market: the market that existed in 2009 is entirely different than the market that exists today. Hr'g Tr. 2736:8-16 (May 8, 2015) (Shapiro); Hr'g Tr. 1028:15-20 (Apr. 30, 2015)

(Harrison); Hr'g Ex. SX-21 ¶ 39 (Wheeler WDT); Hr'g Ex. SX-17 ¶¶ 42-51) (Rubinfeld Corr. WDT). Sirius XM has offered no evidence to suggest that a rate negotiated in 2009 would in any way resemble the rates that would be negotiated by willing buyers and willing sellers in 2015 for the years 2016-2020.

1034. Sirius XM's analysis also distorts the actual economics of the deal. There is no evidence in the record that SoundExchange—or the record companies—would have willingly agreed to a deal with Sirius XM that set a $0.0016 rate for all seven years of the agreement. The appropriate starting point for a benchmark analysis of the Sirius XM WSA agreement would be either (i) the rate negotiated for the most recent year ($0.0024), since it is the closest in time and most accurately approximates the market rates for 2016-2020, or (ii) the average rate ($0.0020), which reflects the entire negotiated compromise. *See* Hr'g Ex. SX-124 at 2.

1035. Finally, Sirius XM devotes a page in its proposed findings to its contention that other marketplace agreements corroborate its $0.0016 rate proposal. SXM PFOF ¶¶ 65-68. Sirius XM's attempt to piggyback on the other Services' benchmark analyses is just as thin, selective, and arbitrary as was its consideration of its WSA settlement. Without elaboration or any independent analysis, Sirius XM simply declares certain rates calculated by the other Services' experts—the handful that happen to align with Sirius XM's rate proposal—as the "best" benchmark analysis. *Id.* Sirius XM's sparse assessment of only certain marketplace evidence does nothing to credibly bolster its unsupported rate proposal.

VIII. *SDARS II* DOES NOT CORROBORATE SERVICES' PROPOSED RATES

A. NAB Has Abandoned Its Reliance On *SDARS II*

1036. NAB appears to have abandoned its reliance on *SDARS II* as the upper bound of its "zone of reasonableness." Seemingly in recognition of the fundamental flaws of the *SDARS*

benchmark that were brought out during Prof. Katz's cross-examination,[56] NAB's proposed findings are largely silent on what was once its primary benchmark,[57] and nowhere in its brief does NAB affirmatively defend *SDARS II* as an appropriate benchmark.

B. Pandora's And iHeart's Continued Reliance On *SDARS II* As A Corroborative Benchmark Is Misplaced

1037. While NAB appears to have rightfully put its *SDARS II* benchmark to bed, Pandora and iHeart both try to resuscitate their long-dormant reliance on the *SDARS II* as a corroborative benchmark. PAN PFOF ¶¶ 195-205; IHM ¶¶ 258-260. But the fundamental flaws with their attempt to use a regulatory rate governing an entirely different market and set under an entirely different standard as a benchmark cannot be remedied. Because these flaws were detailed in SoundExchange's Proposed Findings of Fact and Conclusions of Law, it addresses them again here only to respond to Pandora's and iHeart's particular attempts to rely upon the *SDARS II* decision to corroborate their rate proposals. SX PFOF ¶¶ 886-896, SX PCL ¶¶ 69-73.

1. SDARS Is A Fundamentally Different Rate-Setting Proceeding Governed By A Fundamentally Different Statutory Mandate

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[56] Hr'g Tr. 5759:15-5772:3 (May 26, 2015) (Katz).

[57] NAB makes only two off-hand mentions of the original upper bound of Prof. Katz's "zone of reasonableness" (NAB PFOF ¶¶ 29, 565). It appears to have shifted to relying on Prof. Katz's adjustments to Prof. Rubinfeld's interactive benchmark as the upper bound of its zone of reasonableness (NAB PFOF ¶¶ 433, 439), even though Prof. Katz repeatedly emphasized at the hearing that he did not intend for the Judges to rely on his analysis in this way. Hr'g Tr. 3119:15-23, 3124:12-16 ("In the end, I did not come down and say, here are my corrections, I recommend using this as an alternative benchmark. I'm not proposing as an alternative benchmark, it's just a criticism.") (May 12, 2015) (Katz). Even more problematically, Prof. Katz's analysis of the interactive service agreements is no better support for NAB's rate proposal than was *SDARS II*. As set forth in *supra* Sections III.B and III.E, NAB's interactive benchmark analysis is riddled with speculative assumptions, analytical missteps, and fundamental conceptual flaws. As Prof. Katz himself seemed to acknowledge at the hearing, his radical adjustments to the rates in interactive service agreements cannot be relied upon as an alternative benchmark. *Id.*

1038. Because the *SDARS II* rates were set by Judges, rather than negotiated in the market, they by definition do not satisfy the willing buyer/willing seller standard. The statute provides that, in establishing rates and rates, the Judges "may consider the rates and terms for comparable types of digital audio transmission services and comparable circumstances *under voluntary license agreements*." 17 U.S.C. § 114 (f)(2)(B)(ii) (emphasis added). Rates that were handed down by Judges in a decision that was appealed by both parties cannot qualify as an appropriate point of reference under this standard. *Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1003 (D.C. Cir. 2014). This alone is enough to fatally undermine the Services' attempt to use the *SDARS II* rates to corroborate their rate proposals. Hr'g Ex. SX-29 ¶ 94 (Rubinfeld Corr. WRT).

1039. In any event, even if a regulatory decision could be construed as a "voluntary license agreement"—which it clearly cannot—SDARS would be a particularly inapt regulatory decision to consider. This is because "the statutory mandate in the SDARS standard creates economic imperatives which differ from the willing buyer/willing seller standard." Hr'g Ex. SX-29 ¶ 95 (Rubinfeld Corr. WRT).

1040. The standard that governs rate-making for satellite radio services requires that the Judges "make determinations and adjustments of *reasonable terms and rates*" based on four enumerated policy factors. 17 U.S.C. § 801(b)(1) (emphasis added). Rates set for webcasters, on the other hand, are of course supposed to be those that "most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller." 17 U.S.C. § 114(f)(2)(B).

1041. As Prof. Rubinfeld testified, as a matter of economics, these are two entirely different mandates. Hr'g Ex. SX-29 ¶ 95 (Rubinfeld Corr. WRT). Neither Prof. Shapiro nor

Profs. Fischel and Lichtman have expressed a view to the contrary. And Prof. Katz expressly disclaimed having offered an opinion that "reasonable rates and terms" and "willing buyer/willing seller" are economically equivalent concepts. Hr'g Tr. 5760:14-5761:3 (May 26, 2015) (Katz); *see also* SX PFOF ¶ 888.

1042. The D.C. Circuit has confirmed that "there is no reason to think" that the term "reasonable rates" is "coterminous" with "market rates," "for it is obvious that a 'market rate' may not be 'reasonable,' and vice versa." *RIAA v. Librarian of Congress*, 176 F.3d 528, 533 (D.C. Cir. 1999). Under 801(b), "'reasonable copyright royalty rates' is defined by the four statutory objectives"—statutory factors that do not apply in this proceeding. *Id.* at 534.

1043. In the *SDARS II* decision itself, the Judges cautioned that the SDARS statutory license (governed by 801(b)) and the ephemeral license (governed by willing buyer/willing seller) have "important differences in their standards for setting royalty rates." *SDARS II*, 79 Fed. Reg. at 23055.

1044. Moreover, in the course of their lobbying to change the standard applicable to these proceedings, the Services themselves have emphasized the fundamental differences between "reasonable rates" and "willing buyer/willing seller." They expressly note that the 801(b) standard, in diametric contrast to 114 (f)(2)(B), does not set rates by reference to a hypothetical marketplace. *Statement of Bruce Rees, on behalf of National Association of Broadcasters*, Hearing on "Music Licensing Part One: Legislation in the 112th Congress," United States House of Representatives Committee of the Judiciary, Subcommitee on Intellectual Property, Competition, and the Internet at 4, n. 1 (Nov. 28, 2012). It is instead a "more flexible, policy-based standard" that is unreliant on benchmark evidence. Comments of National

Association of Broadcasters, *In the Matter of Music Licensing Study: Notice and Request for Public Comment*, Dkt. No. 2014-03, U.S. Copyright Office at 26-27 (May 23, 2014).

1045. At bottom, neither Pandora nor iHeart do enough to address the fundamental failing of their *SDARS II* benchmark: "satellite radio and [w]ebcasting operate under two totally different royalty administrations." Hr'g Tr. 5472:16-19 (May 22, 2015) (Frear). Because they have done nothing to transform the policy-driven *SDARS II* rate into the "strictly fair market value" rate that must be adopted here, the Services' benchmark analysis of *SDARS II* is irrelevant to the rate-setting task at hand. *Web I Final Order*, 67 Fed. Reg. 45240, 45244 (July 8, 2002).

2. Satellite Radio Is A Different Business That Operates In A Different Licensing Market: Services' Virtually Wholesale Transplant Of Satellite Radio Rates Without Careful Adjustment Is Improper

1046. While Pandora's proposed findings never expressly acknowledge the "reasonable rates" standard that governed the rate-setting proceeding in *SDARS II*, iHeart does make an off-hand reference to the rate being set under a different standard. IHM PFOF ¶ 258. iHearts contends that, despite this, the *SDARS II* rate nevertheless "provides a reasonable proxy for the rates that would satisfy the willing-buyer willing-seller standard because it is set using market evidence." *Id.*

1047. However, the mere fact that market evidence was introduced in *SDARS II* to guide that entirely different rate-setting process in no way makes the Services' reliance on *SDARS II* more proper. The market evidence used to set rates for satellite radio would yield an entirely different result if applied to set the rates for webcasters, even assuming that the market evidence was interpreted under the same willing buyer/willing seller standard. In other words, the consideration of the market evidence in *SDARS II* was based on unique attributes of the satellite market that would not apply here. SoundExchange set forth the key distinguishing features of the satellite radio market in its Proposed Findings of Fact. SX PFOF ¶¶ 889-896. Rather than

repeat that analysis here, SoundExchanges incorporates it by reference to reiterate that the "satellite radio market and the webcasting market are too dissimilar to simply transpose a rate from one into another." SX PFOF ¶ 889.

1048. With respect to the market evidence introduced in *SDARS II*, Pandora makes reference to it to suggest that it makes *SDARS II* a profitable comparison, claiming that "the rate set by the Judges was influenced, at least in part, by direct licenses that were negotiated by Sirius XM under what appears to be workably competitive conditions." PAN PFOF ¶ 196. Pandora of course fails to mention that the Judges found the Sirius XM direct license benchmark to suffer from substantial infirmities that "diminish[ed] its usefulness." *SDARS II*, 78 Fed. Reg. 23065. Similarly, it is an overstatement to suggest that the rate was "influenced" by those licenses in any meaningful way. The Judges concluded merely that the high end of the rates contained in those agreements could serve as a floor for its analysis of the 801(b) factors. *Id.* at 23065-66.

1049. Pandora's discussion of the evidence that influenced the rates in *SDARS II* is also incomplete. The rate in *SDARS II* was largely derived from "the unadjusted benchmark rate of 13% determined in the prior round of ratemaking," *SDARS I. Music Choice*, 774 F.3d at 1006. That 13% rate was reached in *SDARS I* based on rates contained in SoundExchange's interactive service benchmark. *SDARS I Final Order*, 73 Fed. Reg. at 4093. Not only is Pandora's reliance on *SDARS II* inconsistent, to say the least—given that Pandora vigorously opposes SoundExchange's updated, more comprehensive version of the interactive benchmark in these proceedings—but it fails to address how a 13% rate calculated more than seven years ago could be a current market benchmark for this proceeding. SX PFOF ¶ 896. The market evidence used in *SDARS II* therefore not only was *applied* to a different market (satellite radio vs. webcasting), but it also was *derived* from a different market (pre-2008 vs. 2016-2020).

1050. Pandora at least acknowledges that "there are a number of differences between Sirius XM" and online streaming services. PAN PFOF ¶ 197. It purports to account for these differences. PAN PFOF ¶¶ 198. Its two "adjustments," however, are woefully incomplete and insufficient to rehabilitate the fundamentally flawed *SDARS II* benchmark.

1051. One of Pandora's purported adjustments relates to costs. Pandora concedes that Sirius XM might be unique from webcasters with respect to their financial outlays, but it claims that Prof. Shapiro sufficiently accounted for this difference in his analysis. It notes that the Judges accounted for "Sirius XM's unique investments in satellite technology" in *SDARS II* by applying a downward adjustment pursuant to the 801(b) factors. PAN PFOF ¶¶ 199-200. This adjustment moved the *SDARS II* rate from 13% of revenues to 11%. Pandora's only adjustment to account for differences in the services' costs is simply eliminating the downward adjustment made by the Judges. PAN PFOF ¶¶ 201-202. But this is only a partial-measure. The "fundamentally different" costs of operation would also affect the services' relative bargaining positions. Hr'g Tr. 5471:1-23 (May 22, 2015) (Frear). Sirius XM's unique cost structure therefore goes to the very rates that it would negotiate in the hypothetical market. Simply not applying the 801(b) adjustment does nothing to account for the crucial underlying fact that Sirius XM's costs make it a fundamentally different licensing buyer that would negotiate different rates than the services in the webcasting market.

1052. Pandora goes so far as to suggest that Prof. Shapiro's adaptation of the *SDARS II* rate "tends to overstate the appropriate royalty rate for Pandora" because he did not apply the 801(b) adjustment that the Judges applied to account for Sirius XM's unique infrastructure costs. PAN PFOF ¶ 202. Pandora claims that the same adjustment might have been warranted here, or at least a partial adjustment, because Pandora too has made substantial investments. This is a red

herring. Failure to apply a statutory factor that is inapplicable to this proceeding cannot render Prof. Shapiro's analysis conservative.

1053. In sum, neither Pandora nor iHeart's analyses of the *SDARS II* rates accounted for Sirius XM's preferential bargaining position as the sole provider of satellite radio, or for the fact that Sirius XM relies on a subscription-based revenue model, or the differential in consumers' willingness to pay for satellite radio, or how Sirius XM's unique operational costs might affect its demand for sound recording licenses. *See* SX PFOF ¶¶ 890-895; Hr'g Tr. 5762:12-5763:14 (May 26, 2015) (Katz). This failure to fully appreciate the ways in which satellite radio and webcasting are "totally different businesses" renders their attempt to use the *SDARS II* rates inherently unreliable. Hr'g Tr. 5471:1-23 (May 22, 2015) (Frear).

3. iHeart's Conversion Of *SDARS II* Percentage-Of-Revenue Rate To Per-Play Rate Is Improper And Unreliable

1054. iHeart takes the problematic reliance on *SDARS II* one step further. It attempts to convert the percentage-of-revenue rate set in that proceeding to a per-performance rate that may be applied to webcasters. Both Prof. Katz and Prof. Shapiro implicitly recognized that such a calculation is improper. *See* Hr'g Ex. PAN 5022 at 41-45 (Shapiro WDT); Hr'g Ex. NAB 4000 ¶¶ 85-93 (Katz WDT). "[C]onverting a rate from the metric in which it was negotiated"—or, in this instance, handed down by Judges—"into another metric to be used as a benchmark is usually a risky undertaking." *CARP Web I Report* at 42. This principal certainly holds true here. The inherently imprecise nature of the iHeart calculation is evident from the simple fact that iHeart and Pandora suggest that the same *SDARS II* percentage-of-revenue rate corroborates their wildly divergent rate proposals.

1055. To translate the *SDARS II* percentage-of-revenue rate to a per-play rate for non-interactive services, Profs. Fischel and Lichtman improperly used Pandora's revenues and

performance data from 2013. IHM PFOF ¶ 259. An appropriate conversion of the *SDARS II* percentage-of-revenue rate to a per-play rate, however, would have to be based on Sirius XM's revenue and performance data, the latter of which is available.

1056. It is readily apparent why Pandora's data is an entirely inappropriate proxy for Sirius XM's. In 2013 Pandora had a nearly *six-times* smaller revenue base and *three times* more users than Sirius XM. Hr'g Ex. SX-158 at 48, 51; Sirius XM 2013 10-K at 22.[58] This means that Sirius XM generates approximately *18 times* more revenue per user than Pandora. Eleven percent of Sirius XM's $3.8 billion in revenue generated from 25 million subscribers would generate an entirely different per-performance rate than 22% of Pandora's $600 million in revenue generated from 76.7 million users. Profs. Fischel and Lichtman's use of Pandora's revenue-per-play as a substitute for Sirius XM's revenue-per-play to convert the SDARS percentage-of-royalty rate therefore dramatically distorts the actual per-play value of the *SDARS II* rate. Their apples-to-oranges per-play calculation is fundamentally unreliable and can in no way be relied upon to corroborate iHeart's rate proposal.

IX. NON-COMMERCIALS

A. The Judges Should Adopt SoundExchange's Proposal For Non-Commercial Webcasters And Reject the NRBNMLC's Proposal

1057. SoundExchange's rate proposal mirrors the existing rate structure for non-commercial broadcasters. Noncommercial webcasters operating under the statutory license would pay an annual per-channel or per-station performance royalty of $500 for all digital audio transmissions totaling not more than 159,140 aggregate tuning hours (ATH) in a month, which corresponds to 218 concurrent listeners, on average. For digital audio transmissions totaling in

[58] *Available at* http://files.shareholder.com/downloads/SIRI/4161239498x0xS908937-14-6/908937/filing.pdf.

excess of 159,140 ATH in a month, SoundExchange proposes that the noncommercial webcaster pay a royalty equivalent to the usage-based per-performance fee applicable to commercial webcasting. Here, that would be $0.0025 for 2016; $0.0026 for 2017; $0.0027 for 2018; $0.0028 for 2019; $0.0029 for 2020.

1058. By contrast, under the NRBNMLC's rate proposal, a non-commercial webcaster would never have to pay more than $1,500 a year in royalties for any station or channel, regardless of the number of listeners on that station or the number of sound recordings performed by that station. And that webcaster would not pay more than $500 a year in royalties if it remained within 3,504,000 ATH annually, which corresponds to 400 concurrent listeners, on average.

1059. Unlike SoundExchange's proposal, the NRBNMCL's proposal is flatly inconsistent with the licenses in the record, the testimony of expert witnesses, and the Judges' prior analysis of non-commercial rates in *Web II* and *Web III*. Instead, the heart of the NRBNMLC's case is the testimony of its two fact witnesses—Gene Henes of Praise Network and Joseph Emert of NewLife FM.

1060. Neither Mr. Henes's nor Mr. Emert's testimony is sufficient to support the NRBNMLC's rate proposal. Both the Praise Network and NewLife FM do not come close to the 218 average concurrent listeners threshold reflected in the existing rates and in SoundExchange's proposal. The Praise Network averages three to four concurrent listeners.[59] And NewLife FM averages fewer than ten concurrent listeners. And these broadcasters are not atypical. As the

[59] In fact, the Praise Network *peaks* at 20 concurrent users. Even if the Praise Network replicated its *peak* usage around the clock, it would reach just 10% of the ATH threshold.

NRBNMLC concedes, 97% of non-commercial broadcasters do not exceed the 159,140 ATH/month threshold.

1061. In effect, the NRBNMLC is attempting to use evidence from two very small non-commercial broadcasters that currently pay only the minimum fee—and would continue to pay only the minimum fee under both SoundExchange's and the NRBNMLC's proposals—to support a rate proposal that would unconditionally cap the royalty fees at $1,500 for much larger broadcasters.

1062. Moreover, while both Mr. Henes and Mr. Emert testify regarding the royalty rates they would prefer, their testimony is completely untethered from the willing buyer/willing seller standard that applies to this proceeding. The NRBNMLC failed to introduce evidence that *any* willing seller would voluntarily agree to the capped royalty rate in its proposal. Indeed, the few license agreements that NRBNMLC does discuss—the SoundExchange-NPR settlement and the SoundExchange-CBI settlement—show that willing buyers and willing sellers would not agree to the NRBNMLC proposal.

1063. Finally, the NRBNMLC contends that SoundExchange has "defaulted on its obligation to support its rate proposal for non-commercial webcasters by failing to present *any* evidence." NRBNMLC PFOF ¶ 14. This is incorrect and misapprehends SoundExchange's rate proposal.

1064. SoundExchange witness, Prof. Lys, testified that there is no meaningful economic difference between commercial and non-commercial broadcasters. His testimony is consistent with and supported by the Judges' determinations in *Web II* and *Web III* that, beyond a certain point, differentiated pricing between commercial and non-commercial webcasters is inappropriate. Accordingly, SoundExchange's rate proposal for non-commercial broadcasters

that exceed the 159,140 ATH/month threshold is, in fact, supported by *all* the evidence in the record concerning the appropriate rate for commercial webcasters. Beyond a certain threshold, there is no meaningful difference between commercial and non-commercial broadcasters that justifies the NRBNMLC's proposal for differentiated rates.

1065. With respect to those smaller non-commercial webcasters that do not exceed the 159,140 ATH/month threshold, SoundExchange recognizes that the Judges have concluded in the past that differentiated pricing is appropriate. As a result, SoundExchange has preserved the $500 flat fee for these non-commercial webcasters at the threshold that the Judges have previously endorsed. The NRBNMLC has not introduced any evidence showing why this threshold is inappropriate.

1. Beyond A Certain Threshold Non-Commercial Webcasters Should Not Receive Preferential Rates

a. The NRBNMLC Has Not Established That Non-Commercial Webcasters Form A Distinct Sub-Market Regardless Of Size

1066. Prof. Lys testified that, from a functional perspective, there is no meaningful difference between a non-commercial and a commercial broadcaster. "For example, both Pandora and iHeartMedia have Gospel/Christian music of the type that would be offered by non-commercial devotional service." Hr'g Ex. SX-28 ¶ 256. There is no reason to assume that a user attaches a special significance to the commercial or non-commercial designation of a broadcaster. As a result, it "defies economic logic that one class of webcaster would be treated differently from the other." *Id.*

1067. In addition, Prof. Lys testified that there is no market-based reason to favor non-commercial broadcasters over commercial broadcasters. In fact, doing so would disadvantage commercial broadcasters "because they would have to compete with noncommercial services with subsidized content costs." Hr'g Ex. SX-28 ¶ 257.

1068. Consistent with Prof. Lys's testimony, the Judges concluded in past proceedings that non-commercial webcasters may be a distinct sub-market, but only "up to a point." *Web II Remand*, 72 Fed. Reg. at 24097.

1069. In *Web II*, the Judges concluded that they could envision circumstances in which it would be appropriate to differentiate between commercial and non-commercial webcasters in setting applicable rates. *Web II Remand*, 72 Fed. Reg. at 24097-98. The Judges cautioned, however, that "as a matter of pure economic rationale based on the willing buyer/willing seller standard, those circumstances undoubtedly must include safeguards to assure that, as the submarket for noncommercial webcasters that can be distinguished from commercial webcasters evolves, it does not simply converge or overlap with the submarket for commercial webcasters and their indistinguishable noncommercial counterparts." *Id.* Ultimately, the Judges selected the 159,140 ATH/month threshold to demarcate the "small" non-commercial submarket and to ensure that small non-commercial webcasters would not encroach on commercial broadcasters. *Id.* at 24099.

1070. Subsequently, in *Web III Remand*, the Judges reaffirmed the analysis from *Web II* and again adopted the 159,140 ATH/month threshold. *Web III Remand*, 79 Fed. Reg. at 23122.

1071. The NRBNMLC has not introduced any evidence that contradicts or rebuts Prof. Lys's testimony. For instance, the NRBNMLC has not introduced evidence that an individual who listens to digital music transmissions from a non-commercial broadcast service, such as public radio, would be unwilling to listen to that same music on a commercial service like Pandora. Nor has the NRBNMLC introduced any evidence that commercial and non-commercial services are unlikely to compete for listeners. In sum, the NRBNMLC has not

presented any survey evidence, expert testimony, or evidence of consumer behavior that would support the distinction it seeks to draw between commercial and non-commercial services.

1072. The NRBNMLC's criticisms of Prof. Lys's testimony are misplaced. First, NRBNMLC criticizes Prof. Lys because he "do[es] not listen to religious broadcasts" and is "not an expert regarding how noncommercial and commercial religious stations program or choose the programs that they provide." NRBNMLC PFOF ¶ 117. NRBNMLC does not provide any support of the notion that an expert need listen to a particular genre or type of music to provide testimony regarding matters of economics. Prof. Lys's testimony was a matter of general economics, and the NRBNMLC has not explained why this testimony is wrong as a matter of economics.

1073. Second, the NRBNMLC criticizes Prof. Lys for not relying on any "surveys," "conversations with . . . simulcasters," or "empirical analysis" for his conclusions. NRBNMLC PFOF ¶ 117. As an initial matter, this criticism simply highlights that NRBNMLC itself has failed to provide any such evidence despite being the participant that is proposing a differentiation between *all* commercial broadcasters and *all* non-commercial broadcasters, regardless of size or programming.[60] Prof. Lys, by contrast, explained that as a matter of basic economics, one should not expect a segmentation between commercial and non-commercial broadcasters. To the extent the NRBNMLC has any contrary "surveys" or "empirical analysis" to refute Prof. Lys's economic analysis, it should have offered such evidence. The NRBNMLC's silence on this front speaks volumes.

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[60] The NRBNMLC's failure to show a clear distinction between commercial and non-commercial services is especially noteworthy considering that it proposes to cap non-commercial fees at $1,500, regardless of usage. Given this fee structure, a non-commercial service would have a dramatic cost advantage over a commercial competitor.

b. The Appropriate Threshold Remains 159,140 ATH/Month

1074. SoundExchange's rate proposal adopts the same threshold for eligibility for the $500 flat fee that the Judges adopted in *Web II* and in *Web III*. The NRBNMLC, by contrast, proposes assessing the usage threshold on an annual basis (3,504,000 ATH annually), rather than the existing monthly threshold (159,140 ATH monthly). Understood annually (an increase of 1,594,320 ATH a year) or monthly (an increase of 132,860 ATH a month), this would represent a drastic increase.

1075. The NRBNMLC has not offered a shred of precedent, economic theory, or empirical analysis in support of this increase. Because the NRBNMLC has not offered any substantive explanation as to why such a change is needed or what benefits would result from its adoption, the Judges should reject this proposal. *Web III Remand*, 79 Fed. Reg. at 23125 (rejecting Live365's definition of ATH).

1076. In fact, the only argument offered by the NRBNMLC in support of this higher threshold is conclusory testimony from a broadcaster that "it is reasonable for Noncommercial Broadcasters to be given some 'breathing room' given that 10 years will have passed by the time that the rates set in this proceeding go into effect in 2016." NRBNMLC PFOF ¶ 143 (citation omitted). This argument is both factually and logically flawed.

1077. First, as a factual matter, since 2011 only 3% of non-commercial broadcasters have exceeded the 159,140 ATH/month threshold and paid more than the $500 fee. Hr'g Ex. SX-2 at 14 (Bender WDT). And the only factual testimony provided by NRBNMLC was from broadcasters who are *significantly* under the current threshold. Thus, the factual record does not support the contention that non-commercial webcasters need additional "breathing room."

1078. Second, this "breathing room" argument misses the entire point of the threshold, which is to act as a safeguard and to prevent overlap between "the submarket for noncommercial

webcasters that can be distinguished from commercial webcasters" on the one hand and the "submarket for commercial webcasters and their indistinguishable noncommercial counterparts" on the other hand. *Web II Remand*, 72 Fed. Reg. at 24097-98. Raising the ATH threshold simply to give non-commercial broadcasters "breathing room" defeats the purpose of the threshold.

1079. By contrast, SoundExchange's proposal to retain the 159,140 ATH/month threshold is supported not only by the *Web II* and *Web III* decisions, but also by other evidence in the record.

1080. The SoundExchange – CBI Settlement supports retention of the 159,140 ATH/month threshold. Under that agreement, a noncommercial educational webcaster that exceeds the 159,140 ATH/month limit must pay the non-commercial rates (which, under SoundExchange's proposal are the same as the *commercial* rates for services exceeding the threshold). Hr'g Ex. NRBNMLC 7034, Attach. at 3. The service must pay these rates for the month in which they exceed the cap and also for the remainder of that year. *Id.* The net effect is the same as with SoundExchange's current rate proposal—for any month in which the station exceeds the 159,140 ATH/month threshold it pays the same rates as commercial broadcasters.

1081. The NRBNMLC argues that the threshold in the CBI Settlement is not a good comparison because no educational broadcaster exceeded the threshold in 2011–2013. NRBNMLC PFOF ¶ 95. But this argument has it backwards. The fact that educational broadcasters can generally stay within the threshold supports the conclusion that the threshold is not too low.

1082. Similarly, the NPR agreement also supports SoundExchange's rate proposal. The NPR agreement applies to 530 stations. Hr'g Ex. NRBNMLC 7024, Attach. at 7. Those 530

stations must share a total of 285 million music ATH per year. *Id.* at 9 (§ 380.32). This means that each station can consume only approximately 54,000 ATH music hours per year.[61] Thus, although the NPR agreement counts only *music* ATH, each station has a significantly smaller pool of ATH to consume (54,000 vs. 159,140). In addition, each NPR station pays approximately $1,000,[62] rather than the $500 proposed for non-commercial broadcasters.[63]

c. The Judges Should Reject The NRBNMCL's Proposal To Redefine The ATH Threshold

1083. The NRBNMLC attempts to increase the ATH threshold through a second strategy—redefining the meaning of ATH. Under the NRBNMLC's new proposal, programs that do not include sound recordings, such as talk programs, would not count toward the ATH threshold. The only testimony in support of this proposal is from Mr. Emert and Mr. Henes. Mr. Emert testified that he "do[es] not think that it is reasonable for [non-music] programming to count toward" the threshold and Mr. Henes testified: "why would we want to pay a music fee for [non-music] programs." Hr'g Ex. NRBNMLC 7000 ¶ 46 (Emert WDT); Hr'g Tr. 5273:8-9 (May 21, 2015) (Henes).

1084. In *Web III*, Live365 made this exact argument—that the definition of ATH should exclude "programming that does not contain recorded music, e.g., talk, sports, and advertising

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[61] 285 million ATH per year, divided by 530 stations equals approximately 54 thousand ATH per year.

[62] $2,800,000 for five years divided by 530 stations equals $5,283 over five years, or approximately $1000 per year. *See* Hr'g Ex. NRBNMLC 7024, Attach. at 9 (§ 380.32(a)).

[63] The NRBNMLC argues that NPR stations may have more than one channel. NRBNMLC PFOF ¶ 102. While an increase in channels would have the effect of reducing the annual fee for each channel, it would *also* reduce the ATH available to each channel. For example, if there were 1000 NPR channels, instead of 530, then the annual fee per channel would be approximately $500, but the music ATH threshold per channel would reduce to approximately 27,000 ATH.

not containing music." *Web III Remand*, 79 Fed. Reg. at 23125. But Live365 did not meet its burden in justifying this new definition. *Id.* Like Live365, NRBNMLC has not provided any substantive analysis in support of its proposal to redefine ATH. Accordingly, the Judges should reject this proposal.

1085. In addition, in making this proposal the NRBNMLC failed to account for the fact that the ATH thresholds are not set to simply measure the consumption of sound recordings, but instead to serve as a "proxy that aims to capture the characteristics that delineate the noncommercial submarket." *Web II Remand*, 72 Fed. Reg. at 24099. Thus, the threshold does not serve simply as a usage meter, but instead serves as proxy for the service's ability to compete with commercial broadcasters. [64]

1086. Moreover, the NRBNMLC failed to justify this proposal with any market evidence that the appropriate threshold is 159,140 *music* ATH/month as opposed to 159,140 *total* ATH/month. To the extent the NRBNMLC's proposal is adopted, the applicable threshold should be reduced to account for the re-definition of ATH. For example, under the NPR agreement, each NPR station is permitted, on average, only approximately 54,000 *music* ATH/month.[65]

2. The Evidence Supports SoundExchange's Proposal And Not The NRBNMCL's Proposal For Non-Commercial Broadcasters

a. The Marketplace Evidence Is Consistent With SoundExchange's Proposal And Inconsistent With NRBNMLC's Proposal

[64] Nor did the NRBNMLC account for the increased administrative burden to SoundExchange and webcasters that would result from a switch to a music-only ATH calculation.

[65] Moreover, in discussing the NPR settlement, the NRBNMLC fails to account for the administrative convenience offered by the agreement. Under the NPR agreement, SoundExchange receives consolidated reporting from NPR, and NPR assumes the burden of working with its stations to accurately complete NPR's reports. Hr'g Ex. NRBNMLC 7024 at 3.

1087. There is no marketplace evidence that supports the NRBNMLC's proposal. Indeed, the NRBNMLC cannot point to a single license agreement that involves the unconditional "capped" $1,500 fee it proposes. Nor can the NRBNMLC point to a single license agreement that adopts an ATH threshold that is the same or similar to the ATH in its proposal.

1088. Unlike the NRBNMCL's proposal, the SoundExchange – NPR agreement does not include an unconditional "capped" fee. Under the SoundExchange – NPR agreement, NPR stations are entitled to use the rates under the agreement only if all NPR stations, in aggregate, remain below a specified annual ATH threshold. By contrast, under the NRBNMLC's proposal, a station could offer listening to an unlimited number of users for $1,500.

1089. Nor does the SoundExchange – CBI Settlement contain an unconditional "capped" fee. Rather, services that exceed the threshold are required to pay the then-applicable non-commercial usage rates. And under SoundExchange's rate proposal, this usage fee would be the commercial rates. Thus, the CBI settlement closely mirrors SoundExchange's rate proposal for non-commercial broadcasters and is additional evidence of the reasonableness of this proposal.

b. The Section 118 License Does Not Support The NRBNMLC's Rate Proposal

1090. For the first time in this proceeding, the NRBNMLC contends that the fees set under the Section 118 musical works statutory license is an appropriate benchmark. But the Judges have explicitly rejected the use of this license as a benchmark: "the musical works benchmark proposed by the Services is based on a very different marketplace characterized by different sellers who are selling different rights." *Web II Remand*, 72 Fed. Reg. at 24098. The NRBNMLC has not introduced any evidence to undermine this conclusion or to demonstrate that the Section 118 rights are comparable to the rights at issue in this proceeding.

1091. Moreover, Section 118 does not apply a willing buyer/willing seller standard. Rather, the standard that applies in Section 118 proceedings allows the judges to take certain policy considerations into account, including: "maximize[ing] the availability of creative works," "affording the . . . copyright user a fair income," and "minimiz[ing] any disruptive impact on the structure of the industries involved and on generally prevailing industry practices." 17 U.S.C. 801(b)(1).

c. SoundExchange's Statements Regarding Proposed Legislation Are Not Relevant

1092. The NRBNMLC suggests that its rate proposal is appropriate because "SoundExchange itself has been willing to accept modest flat fees to cover sound recording performances by noncommercial broadcasters in its effort to seek legislation requiring radio broadcasters to pay for those performances over the air." NRBNMLC PFOF ¶ 108. Of course, Congress, Representatives, and Senators, are not bound to apply a willing buyer/willing seller standard in any legislation regarding terrestrial performance rights. It defies logic to suggest that an organization's willingness to accept a legislative compromise reflects its views on the marketplace rate for sound recordings. The NRBNMLC has not provided any evidence that SoundExchange's willingness to accept a legislative compromise reflects marketplace rates.

d. Mr. Emert's And Mr. Henes's Testimony Is Not Adequate Support For The NRBNMLC's Rate Proposal

1093. The principal evidence offered by the NRBNMLC is testimony from two broadcasters. As SoundExchange discussed in its Proposed Findings of Fact, the testimony of these witnesses does not support the NRBNMLC's rate proposal.

1094. The NRBNMLC's first witness was Mr. Gene Henes of the Praise Network. The listenership on Praise Network stations does not come close to the prevailing ATH threshold. The digital listenership on two of Mr. Henes's stations averages 3-4 concurrent listeners, and on

his largest radio group, Good News Radio, the listenership peaks out around 20 simultaneous listeners. Hr'g Tr. 5275:22-5276:7 (May 21, 2015) (Henes). Mr. Henes even described his data plan covering 100 simultaneous listeners as more than he would need. *Id.* at 5276:16-5277:14. By his own admission, Mr. Henes has no experience with streams that have very large audiences, as his experience is limited to streams "with very low listener levels, not even close to 218" concurrent listeners. *Id.* at 5279:4-20 There is nothing in Mr. Henes's testimony that speaks to noncommercial webcasters who exceed the prevailing ATH threshold.

1095. The NRBNMLC's second witness was Mr. Joseph Emert of NewLife FM. On average, NewLife FM has fewer than 10 concurrent online listeners and tops out at its peak at 100 concurrent listeners. Hr'g Ex. NRBNMLC 7000 ¶ 29 (Emert WDT). In fact, Mr. Emert noted that he has persuaded other religious broadcasters to stream because "their listenership is very likely to be small enough" that they would pay only the flat fee. *Id.* ¶¶ 32-33. Mr. Emert also made an unspecified reference to being aware of larger noncommercial webcasters, but then provided no testimony about how their behavior or finances were affected at that scale of listening. *Id.* ¶ 34. Despite references to their "ministry," Mr. Emert failed to identify a single noncommercial religious broadcaster who exceeded the prevailing ATH threshold. *Id.* ¶ 35.

1096. In sum, the NRBNMLC does not offer *any* evidence from *any* broadcaster that is remotely close to exceeding the 159,140 ATH/month cap. The evidence that the NRBNMLC *did* present shows that SoundExchange's proposal is affordable. Mr. Henes admitted that the annual royalty costs for all five of his Praise Network digital streaming stations ($2,500) is less than 1% of the Praise Network's total revenue, which exceeds a million dollars annually. Hr'g Tr. 5281:15-23 (May 21, 2015) (Henes). Moreover, Mr. Henes testified that to stream one of his stations, KGCR, he pays his streaming provider $588/year ($49/month). Hr'g Ex. NRBNMLC

7011 ¶ 17 (Henes WDT). This payment for bandwidth exceeds the $500 payment that KGCR would pay under SoundExchange's proposal.

1097. Finally, the testimony offered by Mr. Henes and Mr. Emert speaks to only one side of the statutory standard—the willing buyer. The NRBNMLC has not offered any testimony, whether through its fact witnesses or through an expert witness that suggests that willing sellers would accept its proposal. Although Mr. Henes and Mr. Emert testify that they would prefer NRBNMLC's proposal, they have no basis to conclude that willing sellers would accept this proposal.

B. IBS And WHRB Did Not Submit Or Support A Rate Proposal

1098. Despite failing to provide a rate proposal at *any* juncture of this proceeding, IBS and WHRB each submitted proposed findings and conclusions of law addressing a scattershot of issues, which mostly appear to center around whether the Judges should adopt the settlements submitted between SoundExchange and College Broadcasters Inc. ("CBI") and between SoundExchange, National Public Radio ("NPR"), and the Corporation for Public Broadcasting ("CPB").

1099. Whether related to the settlements or not, the proposed findings of IBS and WHRB suffer from a litany of problems, described in detail below, including a consistent failure to adhere to the bounds of the evidentiary record, a general lack of evidentiary support for the assertions made therein, and an absence of any meaningful rate or term proposal. For these reasons, the proposed findings and conclusions of IBS and WHRB should be afforded no weight.

1. To The Extent IBS Attempts To Oppose The NPR And CBI Settlements Through Its Findings, That Effort Should Be Rejected

a. These Findings Are Not An Appropriate Vehicle To Raise Objections To The Proposed Settlements

1100. The Judges provided the opportunity for and received comment on the NPR and CBI settlements, including from parties who are not participants in this proceeding. With respect to the settlement between SoundExchange, NPR, and CPB, the deadline for comment came and passed without any substantive objection. *See* Hr'g Tr. 236: 2-4 (Apr. 27, 2015) (Barnett, C.J.) (the only comment came from IBS); *id.* at 228:4-7 (Malone) (IBS's comment is not a substantive objection to the proposal). Accordingly and appropriately, the Judges noted that adoption of the settlement was only "a matter of logistics" and there was "no reason not to recommend acceptance." *Id.* at 236:4-17 (Barnett, C.J.).

1101. With respect to the CBI settlement, Chief Judge Barnett made clear to IBS's counsel that the Judges' consideration of comments related to that settlement "will be done in the context of that settlement" and not in the specific course of this proceeding. Hr'g Tr. 6269:3-11 (May 28, 2015) (Barnett, C.J.). This is the appropriate way to consider the CBI settlement because it allows for the overall consideration of *all* comments, including those submitted by organizations and individuals who are not parties to this proceeding.

1102. Moreover, if IBS or WHRB felt that testimony or evidence was necessary concerning the CBI settlement proposed in October 2014, IBS and WHRB had every opportunity to present rebuttal witness testimony by the February 2015 deadline. They both chose not to do so. SoundExchange even put forward a witness, Mr. Bender, who addressed the CBI settlement in his written testimony. Both IBS and WHRB could have cross examined him on that subject. They both chose not to do so. Accordingly, the Judges should reject consideration in this proceeding of the proposed findings of IBS and WHRB that relate to the settlements proposed by SoundExchange.

b. IBS's Attempts To Oppose The CBI Settlement Are Without Merit

1103. IBS's contention focuses on the ability to pay of its member stations. But, as discussed elsewhere, ability to pay is not a relevant factor in determining the appropriate royalty. *See supra* Section II.B.4.

1104. In fact, there is an absolute dearth of evidence to support IBS's ability-to-pay contentions. IBS has presented no evidence at all that its members are not able to pay the rates proposed by the SX-CBI settlement. IBS does note that "high school and academy webcasters . . . are less well-funded than webcasters operating more hours and days and/or with paid student staffs." IBS PFOF at 4. This, however, does *not* provide any factual record supporting the bold contention that IBS members categorically cannot afford the reasonable $500 royalty rate proposed under the CBI settlement.

1105. There is also no evidence to suggest that IBS members occupy a "distinctive sub-market with a distinctive economic base" than CBI college broadcasters. IBS PFOF at 5. IBS cascades assertions that there may be variance among noncommercial webcasters in terms of listenership. However, to the extent that IBS members qualify as noncommercial educational webcasters, there is no evidence to support the sweeping conclusion that they constitute a distinctive sub-market.

1106. IBS points to the covered entities under the NPR settlement. IBS PFOF at 3-4. But SoundExchange is not proposing that IBS members be treated like or compared to the covered entities under the NPR settlement. The far better comparison is that IBS members, like CBI members, are noncommercial educational webcasters.

1107. IBS's attempt to cast aspersions on SoundExchange for sponsoring CBI conventions is both irrelevant and utterly unsupported. IBS PFOF at 6-7. IBS's executive, in testimony that was refused by this court and is not part of this proceeding, infers based on his

own information and belief that SoundExchange has made payments to CBI to pay for the salary of its Executive Director. The implication, presumably, is that such purported payments have something to do with the proposed settlements. Such accusations are as unfounded as they are salacious and offensive. SoundExchange's convention sponsorships to CBI are listed as conventions sponsorships because that is what they are. Notably, IBS has had no problem accepting SoundExchange's participation in its own conferences in the past. Hr'g Tr. 6265:18-22 (May 28, 2015) (Kass) (noting that SoundExchange personnel have spoken at IBS conferences).

1108. IBS's statement of such unfounded allegations does not make sense. IBS states, "[b]ut a substantial number of present members of CBI who continued from CBI's relationship with CMA, when such a paid staff was a criterion for membership, presumably still have such a paid staff." IBS PFOF at 7. It is unclear what IBS means by this statement but at best it appears to be an unremarkable allegation: A CBI member who previously had a paid staff continued to have a paid staff after CBI parted ways with CMA.

1109. IBS's other primary contention is that CBI represents only a minority category of college broadcasters. IBS PFOF at 6. This, however, is impossible to verify because IBS has *no* knowledge as to how many of its members engage in webcasting. Hr'g Tr. 6271:2-7 (May 28, 2015) (Kass). So, while IBS has identified its membership, it does not know how many of its members utilize the statutory license nor does it know how that number compares to the number of CBI members that utilize the statutory license.

1110. Nor is there any requirement that a settling party must be the majority of any category; the requirement is merely that the rate proposed is reasonable. IBS does not deny that the rate is reasonable. Nor could IBS do so because the rate is, in effect, a continuation of a

royalty rate applicable to noncommercial webcasters, the rate is equivalent to only paying the minimum annual fee, and there is no evidence in the record proving that the minimum annual fee is unreasonable for IBS members or any noncommercial educational webcasters. *See* Hr'g Ex. NRBNMLC 7034 at 2.

c. IBS's Non-Rate Objections To The Proposed NPR Settlement

1111. IBS raises a series of issues concerning "non-rate conditions" in the NPR Settlement. IBS PFOF at 11-13. But, as counsel for NPR pointed out, IBS has no basis to object to the NPR settlement because neither it nor any of its constituent members are covered entities under the NPR settlement. Hr'g Tr. 234:22-235:4 (Apr. 27, 2015) (Steinthal). Because IBS would not be bound by the terms of the NPR settlement, its objections are not, as a matter of law, a basis to decline to adopt the settlement. *See* 17 U.S.C. § 801(b) (7) (A). Thus, the objections raised in IBS's proposed findings can be ignored.

1112. Furthermore, IBS's contention that the NPR settlement is "not ready for final disposition," IBS PFOF at 11-12, misses the mark. The time for comment has long since passed. No entity bound by the terms of the settlement, including a "small licensee" has raised any objection. And, the evidentiary record in this proceeding has itself closed. Thus, there is no basis to withhold disposition of the proposed settlement.

1113. The remaining "non-rate conditions" raised by IBS appear to be qualms with the substance of the settlement. However, as noted *supra*, IBS's counsel stood before the Judges on the first day of the hearing and announced that IBS does not have a substantive objection to adoption of the NPR settlement. Hr'g Tr. 228:4-7 (Apr. 27, 2015) (Malone). This then forms a second basis on which to reject IBS's additional proposed findings concerning non-rate conditions in the proposed NPR settlements.

1114. Also, IBS asserts that "recent experience with the DCMA [sic] shows that . . . it interferes with student learning in STEM programs." IBS PFOF at 12. IBS cites to no record evidence and there does not appear to be any at all concerning the STEM program or the DMCA. Even were there such evidence, the use of the statutory license is voluntary for a licensee. If webcasters felt that the non-rate conditions of an applicable license interfered with their mission, including an educational mission, they would always have the choice *not* to use the license. Finally, IBS proposes no term to remedy this alleged interference, thereby offering no alternative to address the concern.

1115. Similarly, without citation to any piece of evidence in the record of this proceeding, IBS makes an oblique reference to SoundExchange legal fees from 2012. IBS PFOF at 12. IBS does not even make an attempt to demonstrate the relevance of its reference instead choosing to make reference to "the Constitutional purpose." None of this has any relevance to the "non-rate conditions" of the NPR proposal which is, nominally, the subject heading for this part of IBS's findings.

1116. Finally, IBS criticizes "artificial restrictions" on webcaster programming by making broad assertions that these restrictions are unnecessary and harm student learning. First, IBS cites no evidence to support that proposition, which itself is unmoored to the evidentiary record of this proceeding. Second, IBS seems to be making reference to the sound recording complement restrictions. Those are statutory limitations that cannot be altered in this proceeding. *See* SX Reply COL Section VI; *infra* Section X.B.9.

d. WHRB's Objection To Signatory Requirement In The CBI Settlement

1117. WHRB's findings largely focus on two terms in the proposed CBI settlement, based upon WHRB's comments to that settlement. WHRB PFOF at 2-6. As discussed *supra*, this is not the appropriate vehicle to raise such objections.

1118. In any event, WHRB's objection is that the proposed CBI settlement would prohibit student officers from signing usage reports. WHRB PFOF at 2-3. The scant record that exists on this issue undermines WHRB's contention. Despite grand references to Biblical authority and constitutional anti-commandeering cases, the station admits that it already has a designated faculty advisor. WHRB PFOF at 3. The station's only further objection is that their current advisor is "not involved in the day-to-day operations of the radio station." *Id.* By contrast, by requiring a representative or authorized member of the applicable educational institution, the proposed settlement ensures that someone authorized by the institution itself is providing the certification.

e. WHRB's Objection To Calculation Of ATH

1119. WHRB's other objection to the proposed CBI settlement is that the calculation of aggregate tuning hours should be done on a music-only basis. SoundExchange has addressed the propriety of such a proposal in detail elsewhere. *See infra* Section X.B.8 (addressing NAB and NRBNMLC proposals).

1120. Furthermore, there is no evidence whatsoever that WHRB approaches the aggregate tuning hours cap, whether assessed on a music-only basis or not. However, if noncommercial educational webcasters were forced to segregate programming on the basis of music versus non-music, that would require an additional layer of reporting and thereby increase the administrative burden of licensees who are otherwise unlikely to approach the aggregate tuning hour cap. Consequently, there is no practical effect to WHRB's objection except to increase the reporting burden on noncommercial educational webcasters.

2. IBS's Findings Focus On Evidence That Was Not Properly Admitted Into The Record

1121. The IBS findings rely on evidence that was specifically refused by the Judges. For instance, during the hearing, IBS attempted to ask questions and admit into evidence its comments related to the CBI settlement. Hr'g Tr. 6266:25-6267:8 (May 28, 2015) (Malone). In response to SoundExchange's objection, Chief Judge Barnett made clear that those comments would be considered "in the context of that settlement," not in the context of this proceeding. *Id.* at 6269:3-11 (Barnett, C.J.). IBS, however, publishes those comments almost verbatim into its proposed findings. *See* IBS PFOF at 6-8. In fact, IBS notes in its proposed findings that the "facts internal to CBI are drawn from the attached affidavit [sic] Frederick J. Kass, IBS's CEO, executed on information and belief." IBS PFOF at 6 n. 2. That affidavit is not part of the evidentiary record in this proceeding and is not attached to IBS's proposed findings.

1122. Similarly, though IBS presented no evidence whatsoever concerning the proportional rate it attempts to infer from the NPR settlement, it now relies on calculations drawn from its comments concerning the NPR settlement. *See* IBS PFOF at 8-10. IBS presented only one witness on direct, Captain Kass, and no witnesses on rebuttal. No part of Captain Kass's written or oral testimony addressed the NPR settlement or the calculations that IBS attempts to derive therein. IBS could have attempted to question Captain Kass on these issues or introduce its calculations into the record in this proceeding, but it did not.

1123. Had it done so, SoundExchange's objections to the testimony, including but not limited to the belated introduction of testimony that exceed the scope of the proffered witness's written testimony, lack of foundation, lack of authenticity, absence of a proper sponsoring witness, etc. could have been heard and ruled upon. Also, if such testimony were permissible, SoundExchange could have had the opportunity to cross-examine the witness on the propriety of

these calculations. Yet the issue never matured to this point because IBS never so much as attempted to introduce it into the record. The testimony cited by IBS concerns IBS's comments concerning the *CBI settlement*, not the settlement between SoundExchange, NPR, and CPB.

1124. IBS's failure to introduce the very evidence referred to in its proposed findings is not without serious consequence for the integrity of the record. The proposed findings include reference to 2009 and 2010 settlements, estimates of proportionate usage among different types of webcasters, factual interpretations concerning the mechanics of the NPR settlement, etc. *See, e.g.*, IBS PFOF at 8-11. To allow a party to skirt the responsibilities of properly admitting evidence would do nothing but encourage parties to hide important evidence in comments adjacent to the issues in the proceeding and then cite freely to them in the post-hearing proposed findings of fact. It deprives other participants of the appropriate opportunity to both object to the admissibility of such evidence and test the strength of such evidence through cross-examination.

1125. IBS even attempts to sneak evidence into its findings which simply does not exist in the record. IBS's findings, for instance, cite to page three of IBS exhibit 9000 (Captain Kass's written direct testimony) for the proposition: "Some members of IBS have direct licenses from some artists so that the hours devoted to webcasts thereof are outside the statutory license." There is no such statement, or any statement concerning direct licenses with artists, on page three or any page of Captain Kass's written direct testimony. *See* Hr'g Ex. IBS 9000 (Kass WDT).

1126. There is no reason to excuse IBS from adherence to the appropriate evidentiary standards or procedural regulations. IBS is one of the most experienced participants in proceedings before the Judges, having participated in the *Web II* and *Web III* hearings, appeals, and remand proceedings. IBS is represented by able counsel who is experienced in proceedings before the Judges. Consequently, there is no justification (and no justification offered by IBS)

for its failure to adhere to the basic expectations to properly introduce evidence into the record and rely solely upon evidence that was properly admitted in the record in its proposed findings.

3. IBS And WHRB's Findings Are Largely Mooted By The Minimum Fee

1127. No participant, including IBS and WHRB, has opposed SoundExchange's proposal to continue the statutorily required minimum fee at the same rate as has been applicable to noncommercial webcasters in the current rate period. No participant has presented a counterproposal to that minimum fee rate.

1128. There is no evidence in the record to contradict the record evidence demonstrating that a minimum fee at this level is justified as a partial offset to the costs associated with administering the statutory license. *See* SX PFOF Section XV. These administrative costs apply to all licensees, large or small, because SoundExchange undertakes to process all reports of use that are submitted, irrespective of the amount of sound recordings used by the licensee. As Mr. Bender explained when questioned by IBS's counsel, Mr. Malone:

Q All right. And is -- do you process 100 percent of the -- of such reports, or are there some that do not meet the screening test?
A Yes, we inventory 100 percent of them and we attempt to process 100 percent of them. Some fail basic data criteria validation.
Q Would you elaborate on what sort of a test you're applying that they fail?
A Well, at the simplest level, we make sure that there's an artist reported in the reports of use. There has to be a name of the service. There has to be a broadcast period. There has to be basic data which tells us what this is.
Q Now, is there a size criterion in terms of the number of ATH or the number of data points that qualify the report for processing?
A No.
Q So you process 100 percent that are processed.
A That's correct.
MR. MALONE: Thank you.

Hr'g Tr. 2586:3-24 (May 8, 2015) (Bender)

1129. The conclusion of IBS's proposed findings includes the cryptic statement that "[a]nnual royalties collected by SoundExchange should be limited to only those that exceed annual amounts that SoundExchange determines [sic] can collect cost-effectively." IBS PFOF at 13. To the extent this is an attempt to offer an alternative minimum fee proposal by implication, it is unclear what amount IBS would propose. There is no evidence in the record or cited by IBS concerning the annual amounts SoundExchange can "cost-effectively" collect. If anything, the statement suggests that the royalty rate applicable to IBS members should be only the rate which exceeds the minimum fee necessary to cover the administration of the license, i.e. cost-effective collection. In any event, this stray statement is nowhere near sufficient to oppose the adoption of SoundExchange's otherwise uncontested minimum fee proposal.

1130. Furthermore, as in *Web III*, there is no record evidence to suggest that noncommercial webcasters, including IBS members, are not unable to pay a $500 minimum royalty. *See Web III Remand*, 79 Fed. Reg. at 23123. There is no testimony whatsoever concerning identifying the operating budgets of any IBS members or suggesting that the minimum royalty fee proposed by SoundExchange would intrude on what those webcasters are willing or able to pay.

1131. There is also no evidence in the record or otherwise to suggest that WHRB or IBS's members have or will exceed that aggregated tuning hour threshold identified in SoundExchange's minimum fee proposal. If anything, IBS attempts to argue the opposite: that its members use an exceedingly small number of sound performances per year. Consequently, there is no evidence to suggest that either WHRB or IBS members will be subject to a noncommercial royalty rate in excess of the $500 annual minimum fee. Consequently, this

largely moots any suggestion that IBS or WHRB members should be subject to a different noncommercial royalty rate.

1132. To the extent the Judges consider IBS's position with respect to the proposed CBI settlement, the same principle holds. The proposed settlement includes a $500 royalty fee covering up to 159,140 aggregate tuning hours per month, but also includes a $500 minimum fee.

4. IBS And WHRB Do Not Appear To Propose Or Support Any Particular Royalty Rate Applicable To Noncommercial Webcasters

1133. Although required to do so, IBS and WHRB did not state requested royalty rates at the filing of their written direct statements. *See* 37 C.F.R. § 351.4(b) (3) ("required content" of written direct statements includes that "each party must state its requested rate"). Furthermore, though parties are allowed to revise requested rates up to and including the filing of proposed findings of fact and conclusions of law, see 37 C.F.R. § 351.4(b)(3), neither IBS nor WHRB has identified a requested royalty rate.

1134. Nor do IBS or WHRB follow the minimal procedural requirements concerning numbering and organization of proposed findings of fact or conclusions of law. 37 C.F.R. § 351.14(c) ("Proposed findings of fact shall be numbered by paragraph and include all basic evidentiary facts developed on the record used to support proposed conclusions, and shall contain appropriate citations to the record for each evidentiary fact. Proposed conclusions shall be stated and numbered by paragraph separately. Failure to comply with this paragraph (c) may result in the offending paragraph being stricken).

1135. WHRB's proposed findings clearly do not speak to any proposed rate but merely concern some terms in the proposed CBI settlement. *See* WHRB PFOF.

1136. IBS's closest suggestion of a rate is a statement in the conclusion of IBS's proposed findings that (a) "[e]ducationally affiliated, noncommercial webcasters (as defined by statute) should pay proportional royalties for their proportional licensable use at the rate set for 'public entities' webcasting use"; and (b) "[a]nnual royalties collected by SoundExchange should be limited to only those that exceed annual amounts that SoundExchange determines [sic] can collect cost-effectively." IBS PFOF at 13. IBS does not specify what those proportional rates or annual royalties should be.

1137. This is familiar territory. *See Web III Remand*, 79 Fed. Reg. at 23121 ("The IBS rate proposal is more difficult to discern."); *see also id.* at 23121 n. 57 ("IBS did not file a formal rate proposal with the Judges prior to the evidentiary hearing. Instead, IBS included a vague request in the written direct testimony of one of its three witnesses, Frederick J. Kass, Jr., IBS's chief operating officer."). At least in prior proceedings, IBS included some suggestion of a rate request with its written testimony and later filed a "Restatement of IBS's Rate Proposal" and "Amplification of IBS's Restated Rate Proposal." *See id.* at 23121 n.57. IBS did neither of those things here, leaving an ample amount of uncertainty as to what rate proposal IBS requests the Judges and other participants consider.

1138. The closest that IBS comes to identifying a rate itself is its discussion of a set of "calculations" based on some combination of the proposed settlement between SoundExchange, NPR, and CPB; evidence purportedly pulled from the records in the *Web II* and *III* proceedings, and a Live 365 agreement from 2009 and 2010. IBS PFOF at 9-11. As discussed *supra*, none of this evidence was properly admitted into the record in this proceeding and should therefore be ignored on its face.

1139. Further, IBS's attempt to scramble together these various points of data is unavailing. The "calculation" rests upon rates IBS infers from SoundExchange's proposed settlement with CPB and NPR. However, IBS does not attempt to demonstrate that the settlement is a comparable benchmark for the rates of other noncommercial webcasters. In fact, IBS appears to argue the opposite repeatedly in its findings. *See* IBS PFOF at 3-4 ("The Corporation for Public Broadcasting (CPB)-qualified webcasters are relatively well-funded in comparison to non-CPB-qualified educational webcasters. CPB-qualified webcasters, such as Nation [sic] Public Radio webcasters, have at least five full-time paid staff members, or equivalent. CPB-qualified webcasters have a large per stream number of domestic listeners at any given time."). IBS goes so far as to say "the proposed SX-NPR-CPB and SX-CBI annual rates in no way meet the comparability test for noncommercial royalty rates." *Id.* at 10. Far from demonstrating the NPR settlement is a comparable benchmark on which to justify its calculations, IBS concludes otherwise.

1140. This is consistent with the record evidence which recognizes that "[p]ublic radio consists of a unique set of entities, and has a unique history, organizational structure and funding model. Among other things, public radio receives substantial funding from CPB. Through CPB, the federal government has always paid sound recording royalties for public radio. As a result, public radio presents unique business, economic and political circumstances unlike other participants in this Proceeding or the marketplace." Hr'g Ex. NRBNMLC 7024 at 2. IBS has presented no evidence to the contrary and therefore cannot simply argue that its members should pay a proportionate share of a settlement rate without addressing these issues of comparability.

1141. IBS's calculations also fail to recognize that the proposed settlement includes "a discount that reflects the administrative convenience to [SoundExchange] of receiving annual

lump sum payments that cover a large number of separate entities, as well as the protection from bad debts that arises from being paid in advance." Hr'g Ex. NRBNMLC 7024 at 9. IBS's proposal would do the exact opposite and attempt to segregate payments across many different entities based on their individual usage and would strip away SoundExchange's protection from bad debts of any noncommercial webcasters who fail to pay their royalties. This increased administrative burden would require a significant upward adjustment that is not mentioned much less analyzed by IBS.

1142. IBS's calculations are also unreliable because they rest on assumptions with no basis in the record. For instance, a pivotal component of IBS's calculation of a "per-channel" annual fee is an assumption that there is "an average of four channels per NPR station." IBS PFOF at 10. That is an arbitrary assumption with no basis in the record and yet it plays a crucial role in IBS's calculations. The same is true of IBS's arbitrary allotment of half of the proposed fee of NPR settlement to network entities, which IBS uses to reduce its "calculated" rate by half. *See id.*

1143. IBS's calculations should also be rejected based on their reliance on an ambiguous reference to IBS member usage "according to the records in Web II and III." IBS PFOF at 10. IBS does not identify this usage data with any specificity or demonstrate its continued reliability. Further, IBS has presented no basis upon which it would be reasonable to export usage figures that, even if reliable, could be no more recent than 2009 to a 2015 settlement. There is no such evidence in the record of this proceeding. IBS was free to but chose not to present evidence of its members' usage. This is true with respect to IBS's calculations concerning both the proposed NPR and CBI settlements. *See* IBS PFOF at 10.

1144. The record in this proceeding plainly lacks evidence of usage by IBS members. In fact, IBS's CEO acknowledged that there are IBS members who did not webcast at all, and he did not know what percentage of IBS members engaged in webcasting. Hr'g Tr. 6271:2-7 (May 28, 2015) (Kass).

1145. IBS's calculations also falter because they compare representations of the actual usage of IBS members to the potential usage of entities covered by NPR entities. Assuming *arguendo* that IBS has accurate usage data the calculations follow this path: NPR entities can potentially use up to X total aggregate tuning hours. IBS members have in the past *actually* used, on average, Y percentage of X, therefore the license rate of IBS members should be Y multiplied by X. But IBS does not similarly propose that its members be limited to only their actual past usage, i.e. that IBS members can use no more than 6,366 aggregate tuning hours a month *per entity*. Nor does IBS compare the actual usage of NPR entities to IBS members.

1146. Finally, IBS makes a confusing reference to a 2009 and 2010 agreement between Live365 and SoundExchange. IBS PFOF at 11. IBS does not specify what the agreement was or describe its comparability or attempt to justify its use as a benchmark for rates applicable to IBS members. IBS presents no explanation whatsoever for why a 2010 agreement would be the preferably benchmark in this proceeding except to note that "Live365 is not listed as a party to this proceeding." *Id.* This reference is all the more confusing because Live365 represented the interests of *commercial* webcasters in the *Web III* proceeding.

1147. IBS also makes an odd statement that "the comparability issue in these proceedings is that legal resources, or lack thereof, limit huge numbers of users of statutory licenses from informing the Board of their part in the marketplace." IBS PFOF at 11. Comparability, however, relates to the assessment of proffered benchmarks, not to the costs of

litigation. The legal resources associated with participation in the proceedings simply do not speak to the royalties that should be required of noncommercial webcasters.

5. IBS's Ambiguous Allusion To A Need For Legal Clarification Is Meritless

1148. IBS asserts without any specificity that "[a] conflict between state statues [sic] and federal statutes needs clarification." IBS PFOF at 2. The conflict, according to IBS, is that SoundExchange is authorized under federal law to engage in lobbying or advocacy efforts but that some state laws prohibit using state funds to support organizations that are or fund lobbying groups. *Id.*

1149. IBS's only legal support for this allegation is a footnote citation to a multi-state compilation on the limits of the use of public funds. IBS PFOF at 2 n.1. IBS provides no specific legal analysis or case law raising analogous authority, instead making broad references to a handful of state statutes. This is by no means sufficient analysis to justify a proposed conclusion of law because it is too vague.

1150. In fact, even a basic legal analysis of the issue suggests otherwise. While IBS cites statutes from Hawaii, Iowa, New Hampshire, and Washington to support its argument (IBS FOF at 2 n.1) the text of these statutes makes clear that they only prohibit the use of state funds for lobbying purposes, not the use of state funds to purchase goods or non-lobbying services from organizations that separately engage in lobbying incidental to their businesses. *See, e.g.*, Haw. Rev. Stat. § 42F-103(a)(3) (2015) (prohibiting state grant recipients from "us[ing] state funds for . . . lobbying activities"); Iowa Code Ann. § 68B.8(1) (2015) (prohibiting the use of public funds to employ a person whose primary responsibility is legislative advocacy); N.H. Rev. Stat. Ann. § 15:5 (2015) (prohibiting the use of state funds "to lobby . . . attempt to influence legislation . . . participate in political activity, or contribute funds to any entity engaged in these

activities"); Wash. Rev. Code Ann. § 42.17A.635(2) (2015) ("no public funds may be used directly or indirectly for lobbying"). SoundExchange has been unable to locate any case law that supports IBS's exceptionally broad interpretation of these state statutes. Given that lobbying is a very common activity for companies and trade associations in any industry, if the statutes cited by IBS prohibited the payment of music royalties because copyright owners, artists or their representatives are engaged to some extent in government advocacy, state grantees and instrumentalities would be prohibited from buying pretty much anything. Moreover, the Judges' task is to determine royalty rates and terms that meet the willing buyer/willing seller standard, not to adjudicate whether particular licensees may be unable to take advantage of the statutory license based on asserted limitations external to the Copyright Act that apply only to them.

1151. Moreover, there is no factual record on this point. The only testimony in the record to address the issue comes from IBS's sole witness who made clear that he is "absolutely not" a lawyer. Hr'g Tr. 6272:5-11 (May 28, 2015) (Kass). There was no testimony from that witness or any IBS member or other educational webcaster identifying any factual situation in which the paying of statutory royalties to SoundExchange raised issues with compliance departments, legal departments, or law enforcement.

1152. There is no requirement that an educational group, or any group, elect to use the statutory license. The statutory license is always voluntary for the webcasting service. Thus, if a possible licensee believes that the applicable local or state laws prohibit the paying of statutory royalties, the possible licensee – including an IBS member – is always free to elect not to use the statutory license and either not webcast or seek direct licenses. Of course, there is no evidence presented by IBS or anywhere in the record to demonstrate that any prospective statutory licensor has had to make such a choice.

1153. Finally, IBS has asserted the need for clarification but has proposed no rate or term to provide the clarification it requires. Thus, even were there an issue meriting clarification, there is no proposed rate or term to provide such clarification.

X. PROPOSED TERMS AND REGULATIONS

1154. SoundExchange's Proposed Findings of Fact addressed the terms issues raised in the Services' proposed findings. SX PFOF Section XVII, ¶¶ 1266-1333. SoundExchange will only briefly revisit those issues here to highlight erroneous arguments in the Services' proposed findings and gaps in their evidence. This section responds to: (i) PAN PFOF Section VI, ¶¶ 409-424; (ii) NAB PFOF Section X, ¶¶ 607-655; (iii) IHM PFOF Section VIII ¶¶ 423-442; (iv) IHM COL Section VI, ¶¶ 31-35; and (v) NRBNMLC PFOF Section VIII, ¶¶ 155-159.

A. SoundExchange's Proposed Terms Are Supported By The Evidence And Should Be Adopted

1. SoundExchange's Proposed 30-Day Payment Window Would Align The Statutory License With The Market Norm And Expedite Payments To Artists

1155. SoundExchange showed in its Proposed Findings that the record evidence supports a 30-day payment term for the statutory license. SX PFOF, ¶¶ 1268-1275. The current 45-day payment term is inconsistent with the 30-day term negotiated by the overwhelming majority of willing buyers and willing sellers. Hr'g Ex. SX-14 at 11, Figure 4 (Lys Corr. WDT). Moreover, maintaining a payment term that is out of step with the market unjustifiably complicates SoundExchange's administrative processing and delays payment to artists and copyright owners. Hr'g Ex. SX-2 at 20 (Bender WDT). Reducing the payment term by just 15 days would allow SoundExchange to distribute royalties a full 30 days earlier. *Id.*

1156. Neither Sirius XM nor Pandora dispute SoundExchange's proposal in their Proposed Findings of Fact.

1157. Relying on the testimony of its CFO, Jon Pederson, iHeart suggests in its proposed findings that 30 days would be an "unreasonably short" period of time for iHeart to generate statements of account and calculate its payment liability. IHM PFOF ¶ 441.

1158. iHeart points to Mr. Pederson's testimony regarding the [redacted] But this unremarkable fact does nothing to undermine SoundExchange's proposal.

1159. Nowhere in his testimony does Mr. Pederson provide any evidence that [redacted]. Nor does iHeart even try to reconcile its claim that a 30-day window would be "unreasonably short" with the overwhelming marketplace evidence of other services willingly agreeing to operate on a 30-day timeline. In their negotiations, willing buyers and willing sellers "select terms that are practical, efficient, and avoid excessive costs." *Web II*, 72 Fed. Reg. at 24102. Marketplace evidence therefore offers a far more credible assessment of the appropriateness of SoundExchange's proposal than does iHeart's naked assertion of unreasonableness.

1160. Moreover, iHeart offers no evidence that statutory licensees would be uniquely situated in their ability to process payments within 30 days. *See Web II*, 72 Fed. Reg. at 24107 ("[T]here is no reason to believe that a term governing late payment, which is unrelated to the specific royalty rates of the agreements, would be any different in a DMCA-compliant agreement."). If anything, one would expect that payment to a single entity (rather than to

multiple content owners) would streamline and accelerate the payment process. *See* Hr'g Ex. SX-2 at 5 (Bender WDT) (SoundExchange "minimizes the administrative costs associated royalty collection").

1161. iHeart's only other argument for maintaining a payment term that is inconsistent with the market norm is Mr. Pederson's testimony [redacted]

1162. [redacted]

[redacted]

1163. NAB asks the Judges to maintain the 45-day payment deadline because some of the other statutory licenses currently contain a 45-day payment period. NAB PFOF ¶ 625. But maintaining consistency with other statutory license terms certainly cannot trump clear marketplace evidence that most willing buyers and willing sellers would negotiate a 30-day payment deadline. *See* 17 U.S.C. § 114(f)(2)(B) (requiring that statutory terms "most clearly represent the . . . terms that would have been negotiated in the marketplace between a willing buyer and willing seller"); *Web III*, 76 Fed. Reg. at 13042, *vacated on other grounds* (noting that the goal of maintaining consistency across the statutory licenses is "not overriding"); *SDARS I*, 73 Fed. Reg. at 4098. This is particularly so given that receiving webcasting royalties on a slightly shorter timetable than PSS or SDARS royalties would improve—not hinder—SoundExchange's administrative process, because it would align the payment period for its largest category of licensees with its new norm of monthly distributions and speed the flow of royalties to artists and copyright owners. Hr'g Ex. SX-2 at 20 (Bender WDT).

1164. NAB's other perfunctory objections are likewise no reason to carry forward a 45-day payment term that would not be negotiated by most willing buyers and willing sellers.

66 [redacted]

1165. First, NAB protests that smaller broadcasters would be ill-equipped to meet a 30-day payment deadline because they have "substantially fewer resources to devote to administrative tasks." NAB PFOF ¶ 629. But NAB offers not a shred of empirical support for this blanket assertion, relying entirely on a generic, unsupported statement in the written testimony of Prof. Weil, where he observed that broadcasters have varying business models and varying levels of accounting sophistication. *Id.* (citing Hr'g Ex. NAB Ex. 4011 at 8 (Weil WRT)). But Prof. Weil, who has no personal knowledge of broadcasters' process for making payments to SoundExchange, is certainly not in a position to speak to broadcasters' ability to make payments within 30 days. And the mere fact that variation exists among broadcasters in no way supports NAB's assertion that a 30-day payment deadline would "unreasonably burden" smaller broadcasters. NAB PFOF ¶ 629.

1166. There is simply no evidence in the record that smaller broadcasters could not prepare their (likely proportionally smaller) payments within 30 days, or that record labels and small commercial services would negotiate a longer payment term. Given that smaller services like [redacted] operate under the same ([redacted]) payment term as major players like [redacted], the market evidence in the record supports applying the same 30-day payment term to all statutory services, not giving special treatment to broadcasters because of their "varying levels of operational resources." NAB PFOF ¶ 629; Hr'g Ex. SX-80 [redacted]

1167. Finally, NAB claims that a 30-day payment term would be unworkable if the statutory license were to include a percentage-of-revenue payment branch. But this too is flatly contradicted by the market evidence in the record. The same direct licenses that include a 30-day payment window also include a greater-of payment structure. Hr'g Ex. SX-14 at 10-118, Figure 3 & Figure 4 (Lys Corr. WDT). And the record also shows that simulcasters do not need any more time to calculate percentage-of-revenue royalties than do other streaming services.

[redacted]

2. The Record Supports Designating Royalty Examiners Who Possess Specialized Knowledge As "Qualified Auditors"

1168. Only one Service articulates any objection to SoundExchange's common-sense proposal to expand the "qualified auditor" definition to include royalty examiners who possess the specialized, technical knowledge necessary to conduct royalty audits: NAB. NAB PFOF ¶¶ 615-623. iHeart's proposed findings do not dispute SoundExchange's proposed definition; it even implicitly acknowledges that record evidence justifies the proposal. *See* IHM PFOF ¶ 424 (failing to contest that SoundExchange met its evidentiary burden with respect to proposed qualified auditor definition). Sirius XM and Pandora are also both silent on this issue in their proposed findings.

1169. NAB's objections cannot obscure the record evidence that supports expanding the qualified auditor definition. SX PFOF ¶¶ 1276-1282.

1170. First, NAB claims that SoundExchange's proposed definition would enable audits to be performed by "persons who are not independent and objective." This is simply wrong. Nothing in SoundExchange's proposal to designate experienced royalty examiners as "qualified auditors" would disturb the requirement that the auditor be independent of both parties. *See* SoundExchange Proposed Rates and Terms, § 380.6(c) ("Any such audit shall be conducted by an *independent* and Qualified Auditor.") (emphasis added).

1171. Second, in light of the evidence, NAB does not—and cannot—dispute that most (if not all) CPAs lack the skillset required to conduct a royalty examination, which is more likely to be a mix of technical and industry experience rather than a CPA certification. *See, e.g.*, Hr'g Tr. 3403:4-12 (May 13, 2015) (Herring) (Pandora CFO Michael Herring testifying that CPAs with the requisite technical expertise are a "bit of a unicorn"). NAB suggests, however, that rather than permit qualified royalty examiners with the requisite industry-specific and technical knowledge to conduct audits, the better approach would be to bring in experts to assist unqualified CPAs. NAB PFOF ¶ 621. NAB's proposed solution is needlessly inefficient. Relegating the qualified royalty examiner to the role of assistant would drive up costs and introduce room for error. NAB fails to offer any evidence that a CPA that lacks the requisite skillset to perform a royalty examination would be any better equipped to supervise a royalty examination.

1172. Finally, NAB suggests that maintaining an unnecessarily restrictive definition is nevertheless justified because "some" unspecified number of market agreements require that audits be conducted by a CPA. NAB PFOF ¶ 622. It identifies two such agreements. The

weight of the marketplace evidence, however, shows that most willing buyers and willing sellers agree that qualified royalty examiners are appropriate auditors, regardless of whether or not they have a CPA. Hr'g Ex. SX-22 at 16 (Wilcox WDT) ("WMG's agreements generally do not require that a certified public account ('CPA') perform royalty audits with its digital partners.").[67]

3. The Services Do Not Dispute Eliminating The Acceptable Verification Procedure Provision

1173. SoundExchange's Proposed Findings of Fact showed that the record supports removing the acceptable verification procedure provision currently set forth in 37 C.F.R. § 380.6(e), as it threatens to weaken SoundExchange's audit rights and thereby compromise the integrity of the statutory license. SX PFOF ¶¶ 1283-1286.

1174. None of the Services dispute SoundExchange's proposal in their proposed findings.

B. The Services Have Not Offered Sufficient Evidence To Justify Their Proposed Terms

[67] *See also, e.g.,* [redacted]

1175. "For the Judges to adopt a contested proposed term, the proponent must show support for its adoption by reference to the record of the proceeding." *Web III Remand*, 79 Fed. Reg. at 23124. The Services fall short of meeting this evidentiary burden with respect to each of their various proposals. *Id.*

1. Services' Proposed Changes To Definition Of "Performance" Are Unsupported By The Record And Would Require Upward Adjustment Of Parties' Rate Proposals

1176. Each of the Services' modifications to the definition of performance is, at its core, a rates proposal—changing the definition of "performance" would have a significant economic impact. *Web III*, 76 Fed. Reg. at 13044, *vacated on other grounds*; *accord Web III Remand*, 79 Fed. Reg. at 23125; SX PFOF ¶ 1318. For example, if performances to users outside the United States were removed from the definition, as Pandora has proposed, services would be able to exploit works in the United States without paying for them, and there would likely be a material drop in royalty payments. Neither Pandora nor NAB explain how to make all of the necessary upward adjustments to the parties' various rate proposals to account for their proposed redefinitions of "performance." *Web III*, 76 Fed. Reg. at 13044, *vacated on other grounds*; *accord Web III Remand*, 79 Fed. Reg. at 23125.

1177. Pandora does not identify any evidentiary basis for its problematic and unnecessary proposed modifications to the definition of "performance." SX PFOF ¶¶ 1324-1327. In its proposed findings, Pandora only offers that inserting a geographic limitation into the definition of "performance" would be consistent with the way in which the SDARS definition of "gross revenues" is limited to subscription revenue "directly from U.S. subscribers." PAN PFOF

¶ 419.[68] Pandora fails to explain, however, how the revenue definition for a satellite radio service is relevant to any of the issues raised by its performance definition for webcasting. Satellite radio, for instance, would not be susceptible to the same geo-location difficulties as webcasting. Hr'g Ex. SX-23 at 14 (Bender WRT). An off-hand reference to a definition that governs an entirely different term for an entirely different kind of service is not enough to show that a change to the established definition of performance is needed. *SDARS I*, 73 Fed. Reg. 4098-99.

1178. Even more problematically, Pandora's proposed definition would improperly allow services to exploit works in the United States (through ephemeral copies and transmissions to the border) without paying for them. *See Nat'l Football League v. PrimeTime 24 Joint Venture*, 211 F.3d 10, 12 (2d Cir. 2000) (quoting *David v. Showtime/The Movie Channel, Inc.*, 697 F. Supp. 752, 759 (S.D.N.Y. 1988)). Pandora's definition should not be embraced. Congress specifically contemplated that webcast performances originating in the United States and transmitted abroad would be licensable. *See* Staff of House Committee on the Judiciary, 105th Cong., Section-By-Section Analysis of H.R. 2281 as Passed by the United States House of Representatives on August 4, 1998 at 53 (referring to such transmissions of sound recordings abroad as "licensed pursuant to the statutory license").

1179. NAB likewise fails to justify either of its proposed exclusions to the definition of performance. SX PFOF ¶¶ 1319-1323.

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[68] Pandora's proposed findings do not even attempt to defend its proposal to strike the parenthetical from the definition that explains that "the delivery of any portion of a single track from a compact disc to a listener" is a "digital audio transmission." As Mr. Bender testified, it would be improper to eliminate this language that makes clear that each movement of a symphony is a distinct sound recording. SX PFOF ¶ 1327.

1180. With respect to its proposed exclusion for performances of less than 15 seconds, NAB relies on (i) Mr. Newberry's opinion that "it doesn't make sense" to charge for partial performances, and (ii) Prof. Katz's testimony that duration minima in interactive service agreements make "economic and common sense." NAB PFOF ¶¶ 644-645.

1181. Mr. Newberry's notion that performances should be non-compensable when a listener demonstrates disinterest in a recording is inconsistent with how he regards other content on his stations. Mr. Newberry's contracts with on-air talent, for example, do not contain compensation deductions for instances where listeners tune out or switch stations during their programming. Hr'g Tr. 5112:12-5113:15 (May 20, 2015) (Newberry). He likewise does not refund advertising revenue if listeners turn off the service before an ad finishes or join at the end of an ad. Hr'g Tr. 5113:16-5114:2 (May 20, 2015) (Newberry).

1182. Moreover, NAB's claim that listeners do not "benefit" from a performance when they join at the end or leave at the beginning ignores that a streaming service would derive far less value from dead air than a partial performance. Hr'g Ex. SX-23 at 13 (Bender WRT) ("[I]t is a matter of basic fairness that owners be compensated anytime their music is used by a service to further its business."). To suggest that a user who turns on a service to listen to music, hears a recording she doesn't like, and turns off the service has less value for the service than if the same user turned on the service and heard no music defies common sense. A music consumer who hears a recording—even if it is one the user does not enjoy—is far more likely to "listen to the simulcast and be exposed to advertising" than a user who hears no music at all. NAB PFOF ¶ 645. Nor is it necessarily the case that a listener who does not listen to an entire song is communicating that the listener "was not interested in hearing the song." NAB PFOF ¶ 644. A

listener could certainly derive value from a short performance if they are particularly fond of the song's intro.

1183. Prof. Katz's citation to the duration minima in interactive service agreements is "insufficient to show the need for or benefit of [NAB's] requested redefinition of 'performance.'" *Web III Remand*, 79 Fed. Reg. at 23125; *accord Web III*, 76 Fed. Reg. at 13043-44, *vacated on other grounds*. Undermining the "intrinsic value of the music" being used by services would be uniquely inappropriate in the statutory license context, where "the risk is greater for the recording companies than the services because . . . the recording companies do not have the option of refusing to license." Hr'g Ex. SX-17 ¶ 100 (Rubinfeld Corr. WDT); Hr'g Tr. 1009:16-22 (April 30, 2015) (Harrison) ("[M]usic has value. We go through a lot of investment, spend a lot of cost in order to make that music and people are using, they are getting value out of that music and there should be a certain minimum amount that has to be paid for the listener to have access to that music."). NAB has failed to justify the need for introducing a term that would only heighten this asymmetry of risk.

1184. NAB also does not meet its evidentiary burden with respect to its proposed exclusion for "second connection[s] to the same sound recording from someone from the same IP address." SX PFOF ¶¶ 1322-1323. NAB entirely fails to address the fundamental problem with its proposed definition—it would improperly count distinct performances to distinct listeners as a single performance if those listeners happened to be listening to the service from the same IP address. SX PFOF ¶ 1323.

1185. In sum, "[t]he lack of supportive evidence presented by [the Services] combined with the potential problematic effect on the per-performance rates requires rejection of" the

Services' proposed redefinitions of performance. *Web III*, 76 Fed. Reg. at 13044, *vacated on other grounds*; *accord Web III Remand*, 79 Fed. Reg. at 23125.

2. Late Fees Should Continue To Accrue Separately For Payments And Statements Of Account

1186. Pandora and NAB both propose modifying the late payment provision such that a licensee would be liable for a single late fee if it were to separately submit its payment and statement of account after the payment deadline. PAN PFOF ¶¶ 420-421; NAB PFOF ¶¶ 634-637.[69] Neither is able to point to anything in the record to justify the proposal beyond a brief, bald assertion in Mr. Herring's written testimony. PAN PFOF ¶ 420; NAB PFOF ¶ 635. The unsupported opinion of a fact witness, together with the argument of counsel, is woefully insufficient to satisfy the Services' evidentiary burden. SX PFOF ¶¶ 1289-1293.

1187. As an initial matter, this issue has already been litigated, and the Services have offered no evidence to justify deviation from the Judges' prior determination that "if the payment and the statement are submitted separately and both are late, then the [service] will pay a 1.5% late fee for the late payment and an additional 1.5% late fee for the untimely statement." *SDARS I*, 73 Fed. Reg. at 4100. Given the critical importance of the "timely submission of statements of account to the quick and efficient distribution of royalties," the Judges should not deviate from the requirement of separate late fees for separate late submissions. *SDARS II*, 78 Fed. Reg. 23074; Hr'g Ex. SX-23 at 5 (Bender WRT).

1188. Pandora's counsel suggests that a single late fee would improve incentives for services to submit their late statements or payments as quickly as possible. PAN PFOF ¶ 420. But Pandora overlooks the fundamental fact that without separate accrual of late fees, a service

[69] NRBNMLC joined NAB's proposal and incorporated NAB's arguments as its own but, like NAB, offered no supporting evidence. NRBNMCL PFOF ¶¶ 155-156.

would have no reason to submit its statement on time if it knew its payment would be late (or to submit payment on time if it knew statement would be late). Hr'g Ex. SX-23 at 4 (Bender WRT); *Web II*, 72 Fed. Reg. at 24107 (adopting 1.5% late fee for statements of account based on testimony that "it is not uncommon for SoundExchange to receive late and incomplete statements of account from Services"). Mr. Bender testified that maintaining this incentive is important, as one timely submission is far less burdensome on SoundExchange's operational process than two untimely submissions. SX PFOF ¶ 1292. Having a payment (or statement of account) in hand makes it far easier for SoundExchange to collect the missing piece from the service, as the service's timely submission of the payment (or statement of account) creates a concrete "a liability on the books." Hr'g Tr. 7137:4-12 (June 2, 2015) (Bender).

1189. Finally, separate late submissions create separate, duplicative administrative burdens. SX PFOF ¶ 1291; Hr'g Ex. SX-23 at 4 (Bender WRT). Because a single late fee would permit Services to create administrative costs and require SoundExchange to foot the bill, the Services' proposed modification is inconsistent with the Judges' guiding principle to "make the operation of the statutory licenses as smooth, efficient, and fair as possible." *Web II*, 72 Fed. Reg. at 24106.

3. No Marketplace Evidence Supports Services' Proposed Reduction of Late Fee

1190. iHeart, NAB, and NRBNMLC seek to replace the current late payment fee of 1.5% per month with the tax underpayment penalty, an arbitrary and entirely inappropriate reference point for the statutory license. IHM PFOF ¶¶ 427-431; NAB PFO F ¶ 638. The record does not support their proposal. SX PFOF ¶¶ 1294-1297.

1191. Market agreements between record companies and streaming services "are the best evidence as to the appropriate late fee." *Web II*, 72 Fed. Reg. at 24107. The Services

cannot identify a *single* marketplace agreement that contains the tax underpayment penalty as a late fee. Instead, the majority of marketplace agreements in the record specify late fees of 1.5%, just as they did when the Judges set the 1.5% late fee in Web II. Hr'g Ex. SX-14 ¶ 39 (Lys Corr. WDT); *Web II*, 72 Fed. Reg. at 24107.[70]

1192. NAB's blanket assertion that its proposed late fee is "more reasonable" cannot outweigh the assessment that has been made by willing buyers and willing sellers in the market. NAB PFOF ¶ 638. Neither can iHeart's vague appeal to "economic principles." IHM PFOF ¶ 427. The marketplace evidence unambiguously supports carrying over the statutory license's 1.5% late fee and roundly rejecting the Services' proposal. *Web II*, 72 Fed. Reg. at 24107 (rejecting Services' proposed late fee when their supporting witness could not "provide a single agreement that his company had for music service that contained such a rate, nor did he state that he was aware of any agreements containing such a rate").

1193. Even though iHeart [redacted]. IHM PFOF ¶ 428. But a record label's waiver of a late fee in the context of a private agreement is immaterial here. "While waiving a late fee can promote good feelings in a private agreement and thereby avoid termination of future goods and services by the

[70] *See also, e.g.*, [redacted]

offending party, it has no bearing for a statutory license where copyright owners and performers cannot, short of an infringement determination by a federal court, terminate access to their works under the license." *Webcasting II*, 72 Fed. Reg 24084 at 24107.

4. Permitting Services To Revise Statements Of Account And Reclaim Overpayments Would Inequitably Force SoundExchange, Copyright Owners, And Artists To Pay For Services' Mistakes

1194. The record does not support the Services' several proposals that would allow them to reclaim overpayments and correct mistakes years after they submit their original payment. SX PFOF ¶¶ 1298-1306. These proposals would not only make SoundExchange's administration of the statutory license "operationally chaotic," but it would inequitably tax artists and copyright owners for services' failure to submit accurate statements of account. *Web II*, 72 Fed. Reg. at 24106. "[T]he burden is upon the Service to provide as complete and error-free a statement as possible. All of the information needed to complete the statement—which is neither complex nor lengthy—is in the possession of the Service." *Web II*, 72 Fed. Reg. at 24108 (internal citation omitted).

1195. In order for SoundExchange to carry out its mission to promptly distribute royalties, services cannot be invited to make after-the-fact adjustments with impunity. Once royalties have been processed and distributed, any changes can wreak havoc throughout the distribution chain. SX PFOF ¶¶ 1302-1304. And for those royalties that cannot be clawed back, the unrecoverable debt—caused by the service's error—must be paid for by all of SoundExchange's royalty recipients. SX PFOF ¶ 1305.

1196. Nothing in the Services' proposed findings justifies the operational chaos they seek to impose on SoundExchange. IHM ¶¶ PFOF 432-34; NAB PFOF ¶¶ 639-42; PAN PFOF ¶ 422. Nor do they justify the inequity of taking away royalties rightfully earned by an artist or label to make up for a service's error.

1197. Pandora may think SoundExchange's opposition to its proposal is "cynical" (PAN PFOF ¶ 422), but SoundExchange's opposition is compelled by its charge to promptly distribute royalties and protect the integrity of artists' and copyright owners' payments. Hr'g Ex. SX-11 at 6 (Huppe WDT) ("SoundExchange's core operational goal is to ensure that every artist and record label receives its fair share of royalties from statutory licenses, in the most accurate, transparent, and efficient way reasonable."). The evidence shows that permitting corrections without limitation would impose administrative costs and take rightfully earned royalties out of artists' pockets. The Services' proposals are therefore fundamentally incompatible with the overriding goal of making the "operation of the statutory licenses as smooth, efficient, and fair as possible." *Web II*, 72 Fed. Reg. at 24106.

5. The Record Does Not Support NAB's Proposed Notice And Cure Provision

1198. While iHeart concedes that it has not satisfied its evidentiary burden with respect to its proposed notice and cure provision (IHM PFOF ¶ 424), NAB offers a single paragraph to attempt to justify its proposal. NAB PFOF ¶ 650.[71]

1199. First, NAB tries to walk back the far-reaching implications of its proposed provision, which by its plain terms would require SoundExchange to provide formal notice of a material breach "by certified mail" before SoundExchange could "assert [the breach] in any way." NAB PFOF ¶ 649. NAB suggests that this broad language would not foreclose SoundExchange's ability to contact a licensee informally without "first provid[ing] notice . . . by certified mail." *Id.* ¶ 650. NAB's assurance that the provision is not as far-reaching as it reads is of little comfort given that the proposed provision continues to contain language that extends to

[71] NRBNMLC again joined NAB's proposal and incorporated NAB's arguments as its own. NRBNMCL PFOF ¶¶ 155-156.

all breaches that SoundExchange "intends to assert *in any way*." As written, the proposed provision creates needless hoops to jump through before SoundExchange could call or email a licensee to resolve an issue. SX PFOF ¶ 1308.

1200. Second, while NAB offers no evidence to suggest that there is a demonstrated need for SoundExchange to provide written notice of licensees' breaches, NAB argues that a notice and cure provision is nevertheless warranted because such provisions are "commonplace contractual terms" in private marketplace agreements. NAB PFOF ¶ 650. But NAB does not propose the same kind of notice and cure provision found in direct licenses, which give the licensor the right to terminate the license in the event the licensee fails to cure a breach. *See, e.g.*, [redacted].

1201. In any event, a notice and cure provision is fundamentally incompatible with the statutory license. If a service fails to comply with the applicable requirements of the statutory license under section 114(f)(4)(B), it has committed copyright infringement. The Judges are not authorized to change this result by adopting a notice and cure provision that would excuse copyright infringement. *See PSS I Final Order*, 63 Fed. Reg. 25394, 25411-12 (May 8, 1998) ("There is no indication in the statutory language or in the legislative history that the scope of the terms should . . . reach substantive issues, such as defining the scope of copyright infringement for those availing themselves of the statutory license.").

6. Regulations Requiring Payment Notifications And Receipts Are Unnecessary

1202. Even though SoundExchange already sends annual reminders to services before their minimum fee is due (SX PFOF ¶¶ 1310), NRBNMLC wants the Judges to create a

regulation that would require SoundExchange to send such reminders. NRBNMLC's desire for such a requirement suggests that some of its members have not been receiving the reminders that SoundExchange sends as a matter of course. Mr. Bender testified, however, that SoundExchange's ability to send reminders is dependent on the services providing an accurate, up-to-date email address. Hr'g Ex. SX-23 at 9-10 (Bender WRT). Accordingly, to the extent any NRBNMLC members have not been receiving annual reminders, it could be because of their own failure to provide SoundExchange with accurate and current contact information. Creating a new mandate compelling SoundExchange to send reminders it already sends would do nothing to solve this problem—it would only create grounds for disputes.

1203. NRBNMLC's proposed regulation that would require SoundExchange to send emails acknowledging receipt of royalty payments is similarly unnecessary and counterproductive. SX PFOF ¶ 1311. NRBNMLC fails to explain why it does not expect its desire for "an official receipt" to be satisfactorily addressed by SoundExchange's online payment portal. NRBNMLC ¶¶ 158-159. Nor does it identify any evidence to suggest that administratively infeasible email acknowledgements would be a preferable form of receipt, particularly given that SoundExchange does not necessarily have a current email address for each of its thousands of licensees. SX PFOF ¶ 1311.

7. Pandora's Proposed Modification To Unclaimed Funds Provisions Is Unjustified And Unbeneficial

1204. Pandora has provided no sound justification for its proposed change to the unclaimed funds provision, much less identified anything in the record that would support its adoption. PAN PFOF ¶¶ 423-424; SX PFOF ¶ 1314. This alone is enough to warrant rejection. *Web III Remand*, 79 Fed. Reg. at 23124.

1205. SoundExchange has invested considerable time, resources, and effort to develop operational procedures consistent with the terms of the statutory license and uniquely suited to the challenging task of distributing statutory royalties. Hr'g Ex. SX-2 at 5-11 (Bender WDT). Applying unclaimed funds to the collective's administrative costs has been the rule since the very beginning of the statutory license—indeed, it was originally recommended by the Copyright Office—and has long been integrated into SoundExchange's operational framework. *PSS I*, 63 Fed. Reg. at 25413, 25425; *see also Web I*, 67 Fed. Reg. 45240, 45276 (July 8, 2002). Disrupting SoundExchange's established distribution process would needlessly create costs and inefficiencies. *SDARS II*, 78 Fed. Reg. at 23073-74. And, as Pandora concedes by omission, these disruptive changes would benefit no one. *SDARS I*, 73 Fed. Reg. 4098.

1206. Moreover, the unclaimed funds provision is entirely lawful and consistent with the statutory framework created by Congress. Pandora disingenuously suggests that the provision currently permits SoundExchange to use "unclaimed funds for its own purposes." PAN PFOF ¶ 424. But SoundExchange's ability to use unclaimed royalties is narrowly constrained—it may only apply such funds to offset its administrative costs, costs that would otherwise be assessed against its members' royalties. 37 C.F.R. § 380.8; 17 U.S.C. § 114(g)(3). The unclaimed fund provision therefore ensures that any unclaimed royalties inure to the benefit of other copyright owners and artists—a fair, common-sense outcome entirely consistent with Section 114.

1207. Pandora's proposal, on the other hand, conflicts with the policy and purpose of the statutory license. Rather than allow unclaimed royalties to flow to creators as part of a comprehensive and efficient federal framework, Pandora's modifications would implement a splintered system in which royalties are subject to various unspecified state and common law

regimes. Altering the provision to require SoundExchange to "handle [unclaimed] funds in accordance with applicable common law or State law" would not only saddle SoundExchange with disruptive legal and administrative costs—driving up the costs for everyone in the process—but it would also threaten to divert money rightfully owed to artists and copyright owners. Second Amended Proposed Rates and Terms of Pandora Media, Inc. at § 380.7. This is not what Congress intended.

1208. Copyright is a uniform federal system of law that preempts state law. *See* 17 U.S.C. § 301(a). Consistent with that, Congress has directed the Judges to implement a comprehensive federal system of compensations for copyright owners and performers for uses of their works subject to the statutory license. 17 U.S.C. § 114(f)(2), § 801. In achieving the objectives of the Copyright Act, the Judges are not required to defer to the states. *See* Exec. Order No. 13132, §4(a)-(c) (Aug. 4, 1999). Moreover, Exec. Order No. 13132 is intended "only to improve the internal management of the executive branch," and does not affect the scope of the Judges' authority under law or the standards to be applied in this proceeding. *Id.* § 11.

8. The Record Does Not Support NAB's And NRBNMLC's Proposed Modification To The Definition Of "Aggregate Tuning Hours"

1209. NAB and NRBNMLC both seek to obtain rate reductions—for "small" commercial simulcasters and non-commercial webcasters, respectively—by narrowing the definition of "aggregate turning hours" ("ATH"). NAB PFOF ¶¶ 631-633; NRBNMLC PFOF ¶¶ 149-150.

1210. Much like the last proceeding, neither proponent of the proposed modification to the ATH definition has offered "any substantive explanation as to why such a change is needed or what benefits would result from its adoption." *Web III*, 76 Fed. Reg. at 13043, *vacated on other grounds*; *accord Web III Remand*, 79 Fed. Reg. at 23125. Instead, both NAB and

NRBNMLC want to alter the ATH definition to maximize the amount of usage their members can get in exchange for the $500 minimum fee.

1211. Under the current ATH definition, no record company would "benefit from programming that does not include any of their content" because no service would more than $500 in royalties for any usage calculated on an ATH basis. NAB PFOF ¶ 633; NRBNML PFOF ¶ 149. This amount is insufficient to cover SoundExchange's administrative costs, much less meaningfully compensate copyright owners for the exploitation of their content. Hr'g Ex. SX-2 at 18-19 (Bender WDT). As set forth in Section IX.A *supra*, NRBNMLC's attempt to further enlarge the subsidy to non-commercial webcasters by narrowing the ATH definition—thereby making more performances covered by the flat $500 minimum fee payment (rather than subject to per-performance rates)—is entirely unjustified. SX PFOF ¶ 1316.

1212. NAB's proposal is even less appropriate. Its proposed ATH definition would be used in conjunction with its rate proposal for "Small Streaming Stations." NAB PFOF ¶¶ 222. NAB's rate proposal for "Small Streaming Stations" would permit commercial simulcasters with up to 876,000 ATH annually (or 100 average simultaneous listeners) to pay only $500 in royalties for the entire year. *Id.* The amount of uncompensated usage implied by NAB's proposed ATH cap for small streaming stations would be even more sizable if accompanied by NAB's narrowed definition of ATH. Even if the current ATH were maintained, NAB's suggestion that a royalty discount of potentially more than $20,000[72] for hundreds of commercial broadcasters would "cause no potential harm to the record labels" is patently unreasonable. NAB PFOF ¶ 225. As SoundExchange thoroughly addressed in Section VI, *supra*, *any* rate

[72] 876,000 ATH a year implies royalties of up to $26,280 at the 2015 NAB rates, assuming 12 performances per hour. (876,000 ATH * 12 performances * 0.0025 = $26,280).

discount for commercial simulcasters is unjustified, much less one of this magnitude. Narrowing the ATH definition would only make NAB's rate proposal for small simulcasters more unreasonable, as it would make a greater number of stations eligible for the discount. Hr'g Ex. NAB Ex. 4199 (more than 500 broadcasters generated between $500- and $26,280-worth of usage in 2014).

9. The Judges Are Not Authorized To Rewrite the Sound Recording Performance Complement And Other Statutory Provisions

1213. iHeart seeks waivers of the sound recording performance complement and the statutory requirement that ephemerals be periodically destroyed. Proposed Rates and Terms of iHeartMedia, Inc., at 2-3, 3-5 (proposed "Other Terms" ¶¶ 1, 3(a), and 3(b)); IHM PFOF ¶¶ 425-426; IHM PCL ¶¶31-35. The statutory license cannot be amended in the context of this rate-setting proceeding. *See* SX PFF ¶ 1332; SX PCL ¶¶ 74-75.

1214. iHeart attempts to obscure the issue by framing its proposals as mere "terms for transmissions" and "implementing regulations" of the statutory license, noting that the Copyright Act grants the Judges authority to establish the rates and terms under the statutory license. IHM PCL ¶ 35. But in granting the Judges authority to establish terms under the statutory license, Congress conceptualized "terms" narrowly. S. Rep. 104-128 at 28 ("By terms, the Committee means generally such details as how payments are to be made, when, and other accounting matters."). The authority to set terms decidedly does *not* allow the Judges to broaden or anyway alter the statutory license's grant of rights. *Id.*; *see also* 17 U.S.C. § 801; 17 U.S.C. § 114(f)(2).

1215. Both waivers that iHeart seeks to codify would undo *express conditions* of the statutory license. *See* 17 U.S.C. § 114(d)(2)(C); 17 U.S.C. § 112(e)(1)(C). iHeart's proposed modifications therefore ask the Judges to "rewrite clear statutory terms to suit its own sense of how the statute should operate." *Utility Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2446

(2014). This the Judges cannot do. *Id.*; *see also Dixon v. United States*, 381 U.S. 68, 74-75 (1965) ("The power of an administrative officer or board . . . [is] the power to adopt regulations to carry into effect the will of Congress as expressed by statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity.").

1216. Rather than identify any legal authority that would permit the Judges to modify *express conditions* of the statutory license, iHeart points to waivers that were negotiated between NAB and the record companies in 2009 as well as [redacted]. IHM PFOF at ¶¶ 425-426. In so doing, iHeart simply makes the unremarkable observation that parties can voluntarily negotiate for different rights than those conferred by the statutory license. 17 U.S.C. § 114 (f)(3).

1217. But the fact that such arrangements can be privately negotiated says nothing about whether the statutory license can be modified in the context of this rate-setting proceeding. It cannot. To the extent iHeart wants a broader or different set of rights than those granted under the statutory license, it must take its request to individual copyright owners, or to Congress.

10. NAB's And iHeart's Proposed Definitions Of Simulcast Continue To Stray Too Far From True Simulcasts

1218. As SoundExchange set forth at length in its Proposed Findings of Fact and in Section VI.C, *supra*, the evidence shows that a segmented rate structure for commercial services would discourage innovation, invite gamesmanship, give simulcasts an unfair competitive advantage, and be inconsistent with the WBWS standard. SX PFOF ¶¶ 897-938. As a result, SoundExchange proposes that the regulations currently set forth in 37 C.F.R. Part 380, Subpart B, including the definition of simulcasts (or "broadcast retransmissions"), be stricken entirely. SX PFOF ¶¶ 1328-1331.

1219. NAB, however, proposes maintaining the regulations from its 2009 Settlement with SoundExchange as separate regulations applicable to commercial broadcasters. NAB PFOF ¶ 608. Recognizing that its original redefinition of simulcast was entirely unworkable, NAB now offers a revised definition. NAB PFOF ¶ 609. NAB's second attempt tries "to more closely tie the simulcast to the over-the-air broadcast." NAB PFOF ¶ 610. But the new proposal retains ambiguous language that would permit simulcasts to deviate from the over-the-air broadcast. The definition treats any transmissions that are "primarily" simulcast from terrestrial radio as simulcasts, but—beyond a generic disallowance of "customized" transmissions—the definition offers no guidance whatsoever as to how much alteration of the terrestrial broadcast would be permissible. Because it would still open the door for gamesmanship and disputes, NAB's revised redefinition fails to fix the fundamental problems in its original proposal.

1220. iHeart does not squarely address the simulcast definition it proposed in October, and, unlike NAB, it does not advocate for separate rates and terms for simulcasts. IHM PCL ¶ 36. It argues, however, that if the Judges were to adopt a separate rate for simulcasts, that separate rate "should apply to *all* songs that are simulcast," "even if a simulcast stream includes some songs that are not played to terrestrial listeners." IHM PCL ¶ 37. Based on its proposed simulcast definition, iHeart seems to maintain that a stream should retain its eligibility for simulcast treatment under the regulations so long as 50.1% of the content on the stream was originally broadcast on terrestrial radio. iHeart Proposed Terms at 3. iHeart asks the Judges to adopt a definition that does not accurately define a true simulcast simply because it may be beneficial for services to be able to engage in extensive substitution of content and advertisements. IHM PCL ¶¶ 37-38. But iHeart does not—and cannot—offer any reason as to why such an aggressively manipulated stream that no longer "literally is terrestrial radio online"

would warrant different treatment than any other streams. NAB PFOF ¶ 70. Defining simulcasts in a way that captures anything other than streams that are literally simulcast from terrestrial radio is ultimately self-defeating. There is simply no reason to give special treatment to "simulcasts" that are no longer simulcasts. SX PFOF ¶¶ 1328-1331.

11. There Is No Basis For NAB's Modification To The Minimum Fee Provision

1221. NAB professes to be confused by SoundExchange's objection to its entirely unjustified proposed revision to the minimum fee provision. NAB ¶ 652. NAB's proposal strikes language that makes clear that each service is obligated to "pay an annual nonrefundable minimum fee of $500 for each of its individual channels, including each of its individual side channels, *and* each of its individual stations, through which (in each case) it makes Eligible Transmissions." 37 C.F.R § 380.12(c) (emphasis added); *accord* 37 C.F.R. § 380.3(b)(1) ("The annual minimum fee is payable for each individual channel and each individual station maintained by Commercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are Commercial Webcasters . . .").

1222. Under NAB's proposed minimum fee provision, a commercial broadcaster would only have to pay a minimum fee "for each of its terrestrial AM and FM radio stations," rather than for each of its individual channels. NAB PFOF ¶ 651. NAB suggests that this revision is harmless because its "provision addresses simulcasting only, so each radio station is a channel subject to the minimum fee." NAB PFOF ¶ 652. But NAB overlooks the possibility that a broadcaster might operate separate side channels. Hr'g Ex. SX-2 at 17 (Bender WDT) ("While the overwhelming majority of [SoundExchange's] licensees operated only one station or channel . . . , some operated multiple stations or channels.").

1223. "As the Judges have noted in previous proceedings, it is reasonable and appropriate for the minimum fee to at least cover SoundExchange's administrative cost." *Web III Remand*, 79 Fed. Reg. at 23124. Because a broadcaster might operate more than one channel, maintaining the language in the minimum fee provision that requires payment for each of a broadcaster's individual stations *and* each of its individual channels is necessary to ensure that SoundExchange's administrative expenses are adequately covered by those stations and channels that pay only the minimum fee. SX PFOF ¶ 1333; Hr'g Ex. SX-2 at 17-18 (Bender WDT) (testifying that SoundExchange averages operating costs of $11,778 per licensee and $1,900 per station or channel). This is especially so given that the "number of individual channels or stations on a licensee's service is often an indicator of greater complexity required to handle [the] payments and reporting." Hr'g Ex. SX-2 at 17 (Bender WDT).

12. The Record Does Not Support Imposing A Six-Month Time Limit On The Completion Of Audits

1224. NAB suggests that its proposed revision of the audit provision is justified simply because an audit can be disruptive for the licensee. NAB PFOF ¶ 648. This bare fact is woefully inadequate to justify NAB's proposed term. There is simply no evidence in the record that would support its adoption. *Web III Remand*, 79 Fed. Reg. at 23124; SX PFOF ¶ 1333.

1225. SoundExchange of course would prefer to conclude all audits promptly. If anyone has an interest in delay, it would be the target of the audits: the services. Requiring completion of an audit within six months would therefore unreasonably weaken the audit provision. Hr'g EX SX-23 at 18 (Bender WRT). NAB's proposal would improperly give uncooperative licensees the ability to use delaying tactics to evade their obligations under 37 C.F.R.§ 380.6 and essentially filibuster SoundExchange's audit rights. *Id.*

13. NAB's Proposed Exemption For Third-Party Programming Is Unjustified And Unreasonable

1226. NAB's proposed provision that would absolve broadcasters of the responsibility to accurately pay and account for performances contained in "programming provided by third parties" is even less justified today than it was in 2004, when the Judges rightfully rejected a similar proposed exemption for third-party programming and observed:

> Transmitting a sound recording to the public is not something that accidentally or unknowingly happens. It takes a significant amount of decision making and action to select and compile sound recordings, and a significant amount of technical expertise to make the transmissions. It is not unreasonable to require those engaged in such a sophisticated activity to collect and report a limited amount of data regarding others' property which they are using for their benefit.

69 Fed. Reg. at 11521 & n.12.

1227. Syndicated third-party programming increasingly constitutes a majority of some broadcasters' programming. Hr'g Ex. SX-23 at 17 (Bender WRT); *see also* Reply Comments of SoundExchange, Docket No. 14-CRB-0005 (RM) at 86 (Sept. 5, 2014). NAB's reliance on a provision in its 2009 WSA Settlement that permitted limited ATH reporting on a temporary basis is entirely inapt. The WSA Settlement permitted broadcasters to report no more than 8% of their performances on an ATH basis in 2015. Hr'g Ex. SX-1574 at 2, § 6(b). NAB's proposed provision would stretch this limited allowance beyond recognition in 2016, allowing simulcasters to potentially report substantially all of their programming on an ATH basis.

1228. NAB does not even attempt to explain how artists and copyright owners could possibly be accurately paid for these simulcasters' usage of their recordings. Nor does NAB explain how broadcasters can be expected to make accurate estimates of the number of performances in third-party programming if they "receive little, if any, information from the programming providers regarding the recordings included in that programming." NAB PFOF ¶ 655. Under NAB's proposal, broadcasters would no longer have an obligation to count their

actual number of performances, and they would essentially be allowed to guess the amount of payment due. If broadcasters are not motivated to seek out the necessary reporting information from their program providers, there is no way to ensure that artists and record companies are paid properly. A proposed carve out for third-party programming that threatens to do so much damage to the statutory license's ability to fairly compensate artists and copyright owners for an entire category of licensees' performances cannot be embraced.

14. Proposed Terms That NAB Failed To Address Must Be Summarily Rejected

1229. In its proposed findings, NAB was entirely silent with respect to several of the proposed modifications contained in its Proposed Rates and Terms, offering neither evidence nor argument.[73] Bare proposals bereft of any justification whatsoever merit summary rejection. *Web III Remand*, 79 Fed. Reg. at 23124, n. 63; *accord Web III,* 76 Fed. Reg. at 13043; *SDARS I*, 73 Fed. Reg. at 4101.

15. Pandora's Other Proposed Modifications Should Be Rejected

a. Pandora's Second Amended Proposed Rates And Terms Include Unmarked Modifications And Other Changes That Could Have Material, Problematic Consequences

1230. Pandora represents that "[o]ther than the changes shown . . . in redline" it did not include in its Second Amended Proposed Rates and Terms "any changes from the terms as set forth by the Judges" in their letter to the participants in this proceeding dated April 2, 2015 concerning regulation drafting (the "Regulation Drafting Letter"). Pandora Second Amended Proposed Rates and Terms at 3. However, that representation by Pandora is false. Pandora did not attach a true redline to its Second Amended Proposed Rates and Terms. Instead, Pandora

[73] *See, e.g.*, NAB Proposed Rates and Terms §§ 380.11 (definition of "broadcaster"), 380.13(g) (distribution of royalties), 380.17 (unclaimed funds).

attempted to sneak by numerous changes to the Judges' suggested regulations that were not marked as changes in the attachment to Pandora's Second Amended Proposed Rates and Terms. A true comparison of Pandora's proposed regulations with those suggested by the Judges' is attached as an appendix hereto.

1231. Some of the specific changes from the current Part 380 regulations that are incorporated in Pandora's proposed regulations (marked or unmarked), but not specifically addressed by Pandora, could have material, problematic consequences. These changes to the current regulations should be rejected.[74]

1232. Pandora's proposed regulations muddle the relationship between the settlements that have been reached in this proceeding and the provisions to be determined by the Judges in the litigated portion of this proceeding. For example, Pandora proposes that the definitions in its proposed Section 380.2 apply "[f]or purposes of this part 380." Pandora Proposed Regulations, § 380.2. However, if SoundExchange's proposed settlements with CBI and NPR/CPB are incorporated in Subparts C and D of Part 380, as indicated in the Judges' Regulation Drafting Letter, the definitions to be contained in Section 380.2 should not apply to Subparts C and D, which contain their own definitions.

1233. As a further example, Pandora proposes a definition of Educational Webcaster in its Section 380.2(k), but Pandora describes a different set of licensees than the Noncommercial Educational Webcasters ("NEWs") defined in Section 380.21 of the proposed CBI settlement. Specifically, Pandora would require an Educational Webcaster to have an FCC license, and so excludes from its proposed definition the internet-only webcasters that qualify as NEWs. *See*

[74] In Section 380.3(b)(2) of its proposed regulations, Pandora retained but questioned the phrase "that have themselves authorized the Collective," which the Judges also questioned. SoundExchange agrees that this phrase seems out of place and could be deleted.

Pandora Proposed Regulations, § 380.2(k) (defining an Educational Webcaster as a "broadcast station" funded under the Communications Act that transmits "radio" and "terrestrial broadcast[s]"). Pandora proposes to exclude its Educational Webcasters from the group of Commercial Webcasters defined in its Section 380.2(g), but it does not propose to exclude them from the group of Noncommercial Webcasters defined in its Section 380.2(o). Accordingly, Pandora would categorize the NEWs covered by the CBI settlement as Noncommercial Webcasters subject to the provisions to be determined by the Judges in the litigated portion of this proceeding. That is obviously inconsistent with the settlement.

1234. Similarly, Pandora's proposed changes would subject to the provisions to be determined in this proceeding the new subscription services currently subject to the rates and terms in Part 383, for which the Judges just adopted a settlement for the 2016-2020 rate period. *See Determination of Terms and Royalty Rates for Ephemeral Reproductions and Public Performance of Sound Recordings by a New Subscription Service*, 80 Fed. Reg. 36,927 (June 29, 2015). The current Part 380 regulations exclude such services from the definition of Licensee in Section 380.2. 37 C.F.R. § 380.2 (Licensee includes a new subscription service "other than a Service as defined in § 383.2(h) of this chapter"). Without explanation, Pandora proposes in its Section 380.2(n) to strike the exclusion for new subscription services subject to Part 383. That proposal is inconsistent with the Part 383 settlement just adopted by the Judges and should be rejected.

1235. In addition to Pandora's proposal to dispose of unclaimed funds pursuant to state law, rather than apply them for the benefit of copyright owners and performers (discussed in Section X.B.7, *supra*), Pandora proposes changes in the timing of such disposition. Pandora proposes that the unclaimed funds be held for "a period of 3 years from the date of final

distribution of all royalties." Pandora Proposed Regulations, § 380.7. This is a change from the current reference to "the date of distribution." 37 C.F.R. § 380.8. It is also inconsistent with Pandora's proposed Section 380.3(i)(2), which measures the three-year period "from the date of payment by a Licensee." Pandora Proposed Regulations, § 380.3(i)(2); *see also* 37 C.F.R. § 380.4(g)(2). Historically, the three-year unclaimed funds period ran from "the date of payment" (presumably by the licensee to SoundExchange). *See* 37 C.F.R. §§ 260.7, 261.8, 262.8. When the Judges adopted current Section 380.8 in *Web II*, they changed the unclaimed funds period to run from "the date of distribution." SoundExchange has understood this change to mean that the start of the unclaimed funds period is SoundExchange's initial distribution date for the relevant royalty payment. That is typically about a month after SoundExchange receives a payment and the associated statement of account and report of use. *See* Bender WDT, at 20-21. Pandora's change would require SoundExchange to hold unclaimed royalties forever, because there can never be a "final distribution" of unclaimed royalties. And if there was a "final distribution of all royalties," there would be no unclaimed royalties to hold for a further three years. Pandora's proposed change makes no sense in the context of an unclaimed funds provision.

1236. Pandora also proposes eliminating the requirement that artists and record companies use an independent auditor to audit SoundExchange. The Judges suggested moving into the definition of Qualified Auditor in Section 380.2 the requirement that the Qualified Auditor be independent, rather than repeating that requirement in various places where the defined term Qualified Auditor is used. Without explanation, Pandora surreptitiously undid most (but not all) of the associated changes suggested by the Judges. That is, Pandora's proposed definition of Qualified Auditor in Section 380.2(s) does not include the concept of independence,

while Pandora included independence in its proposed Sections 380.4(c)(2) and 380.5(b) and (c). However, Pandora proposes removing independence from its proposed Section 380.6(b). *Compare* 37 C.F.R. § 380.7(c) *with* Pandora Proposed Regulations, § 380.6(b). The result is that while SoundExchange *would* be required to use an independent auditor to audit a webcaster, artists and record companies *would not* be required to use an independent auditor to audit SoundExchange. That is not fair. As indicated *supra* in Section A.2, SoundExchange agrees that a Qualified Auditor should be independent. A Qualified Auditor should be independent regardless of who is the target of the audit.

1237. Pandora's proposed Section 380.6 omits the proviso in current Section 380.7(a) confirming that SoundExchange is permitted to agree with its members concerning alternative audit procedures. While that proviso should not be necessary, omitting it without explanation is unjustified and can only lead to disputes. The current language should be retained.

1238. Similarly, Pandora's proposed Section 380.6(b) states that an audit of SoundExchange will be "binding on all parties." This is a change from the current provision, which specifies that an audit of SoundExchange is "binding on all Copyright Owners and Performers." 37 C.F.R. § 380.7(c). While this change probably was not intended to have substantive effects, it might be interpreted as potentially exposing SoundExchange to annual audit by each of the tens of thousands of artists and record companies to which it distributes royalties. That would be inconsistent with the public audit process otherwise envisioned by Pandora's proposed Section 380.6(b), and enormously burdensome for SoundExchange. Again, the current language should be retained.

b. Pandora's Proposed Reorganization Of The Regulations Will Not Make The Regulations More Usable

1239. Pandora's Second Amended Proposed Rates and Terms are based on the reorganization of the Part 380 regulations suggested by the Judges in their Regulation Drafting Letter.

1240. While SoundExchange fully supports the goal of having the rates and terms determined in this proceeding embodied in Part 380 regulations that are logically organized and accessible, SoundExchange does not believe that the organizational structure proposed by Pandora achieves that goal. SoundExchange believes that it is most useful for users of the Part 380 regulations to have all the regulatory provisions applicable to a particular type of licensee gathered in one place, without having other irrelevant provisions interspersed among them.

1241. SoundExchange frequently has occasion to work with statutory licensees to help them understand their obligations under the statutory license. *See* Hr'g Ex. SX-2 at 7 (Bender WDT) (familiarizing new licensees with operating procedures under the statutory licenses); *id.* at 8 (contacting licensees to inquire about issues); *id.* at 6 (working with licensees to obtain corrected reports of use). When SoundExchange needs to educate a licensee about the operation of the statutory licenses, it is convenient to be able to point the licensee to one CFR part or subpart containing all the regulatory provisions applicable to that licensee, and only the regulatory provisions applicable to that type of licensee. SoundExchange is concerned that, under the approach proposed by Pandora, a licensee might (1) overlook provisions applicable to the licensee, when those provisions are scattered among provisions that are irrelevant to the licensee; and (2) be confused by provisions that are irrelevant to the licensee, when those provisions are scattered among provisions that apply to the licensee.

1242. The broadcasters agree with SoundExchange that it is most convenient to address the rates and terms applicable to a particular group of licensees through a freestanding body of

regulations. NAB's Proposed Rates and Terms (June 19, 2015) and NRBNMLC's Proposed Noncommercial Webcaster Rates and Terms (June 19, 2015) both set forth a complete set of regulations applicable only to their respective constituencies. By contrast, Pandora has fallen into exactly the confusion SoundExchange fears. Thus, Pandora professes to "take[] no position . . . on whether the rates for either Broadcasters or Non-Commercial Webcasters shall be the same or different as those Pandora proposes for Commercial Webcasters." Pandora Second Amended Proposed Rates and Terms at 2. However, Pandora proposes definitions of numerous terms applicable only to broadcasters, two different definitions of the term "Broadcast Retransmissions" (*see* Pandora Proposed Regulations, § 380.2(b), (e)), and provisions for the election of small broadcaster status, including a reporting waiver for small broadcasters (*see id.* §§ 380.2(r), (v), 380.3(e)).

1243. As discussed in *supra* Section VI, SoundExchange does not believe that broadcasters should be treated as a separate category of services distinct from other webcasters. However, if the Judges do determine that broadcasters should be treated specially, SoundExchange believes that the organizational structure employed in NAB's Proposed Rates and Terms (June 19, 2015) is the clearer and more usable way to do that.[75]

[75] In its proposed Section 380.3(i)(1), Pandora proposes to apply to all webcasters, including broadcasters, a royalty distribution provision based on current Section 380.4(g)(1). However, the analogous provision in the current regulation for broadcasters, Section 380.13(i)(1) clarifies that SoundExchange only is responsible for making distributions to payees from which it has received the information necessary to pay them (e.g., tax information). 37 C.F.R. § 380.13(i)(1) ("The Collective shall only be responsible for making distributions to those . . . who provide the Collective with such information as is necessary to identify *and pay* the correct recipient." (Emphasis added.)). NAB and NRBNMLC propose to retain that clarification. NAB's Proposed Rates and Terms (June 19, 2015), § 380.13(g)(1); NRBNMLC's Proposed Noncommercial Webcaster Rates and Terms (June 19, 2015), § 380.__(g)(1). If the Judges determine to adopt distinct rates and terms for broadcasters, that clarification should not be lost at Pandora's behest. If anything, it should be extended to all webcasters.

1244. These risks will increase over time if the Judges consolidate the regulations applicable to different types of webcasting licensees as proposed by Pandora. Settlements often have included negotiated variations on terms that otherwise apply generally, because settlements provide the parties an opportunity to address issues in the regulations that are of concern to them within the context of a particular type of service, when it might not be practicable to address those issues in the context of a litigated proceeding involving other participants and numerous contested issues. For example, in this proceeding, the proposed settlement between SoundExchange and CBI includes in proposed Section 380.23(f) variations on a statement of account provision that is similar to Section 380.3(g) in Pandora's proposed regulations. Litigated proceedings also have sometimes addressed variations in regulations applicable to a subset of participants. *E.g., SDARS II*, 78 Fed. Reg. at 23074 (declining to conform PSS confidentiality and royalty verification provisions to other analogous provisions). In the event that future settlements include similar such variations, or future litigated proceedings produce such variations, those variations will over time complicate the codified regulations through the addition of additional exceptions and variations to what might now seem to be straightforward, generally-applicable provisions. The current approach of isolating the regulations applicable to each type of licensee in a separate CFR part or subpart largely avoids this issue, because the variations among the different sets of regulations are not all juxtaposed in a single place.

1245. The approach proposed by Pandora also would create complicated interactions between future settlements and what Pandora proposes as generally-applicable provisions. While the parties to a settlement are often happy to have most of the current regulations continue to apply to the activity subject to the settlement, partial settlements are often reached in proceedings in which other participants may propose in the litigation that the Judges adopt

changes to regulations that would be generally-applicable under Pandora's proposed approach. For example, in this proceeding, Pandora's proposed definition of Performance in its Section 380.2(p) incorporates changes to the definition of Performance that currently appears in Section 380.2. Substantially the same language (without Pandora's proposed changes) is implicitly part of SoundExchange's settlement with CBI. *See* 37 C.F.R. § 380.21; 79 Fed. Reg. 65,609, 65610-11 (proposing to continue § 380.21 with no change to the relevant language). SoundExchange would not have wanted to settle with CBI on a basis that left its deal uncertain due to the possibility of changes to the definition of Performance proposed by Pandora. And it would be improper to alter the terms of a settlement based on argument by a participant not covered by the settlement. *See* 17 U.S.C. § 801(b)(7)(A)(ii) (authorizing the Judges to decline to adopt a settlement only when a participant that would be bound by the settlement objects, and only then if the settlement is unreasonable). Accordingly, if the Judges restructure the regulations as proposed by Pandora, it is foreseeable that future changes to generally-applicable provisions will require complicated exceptions in settlements or to preserve settlements.

1246. The current structure of the Part 380 regulations mirrors other aspects of the Judges' rate regulations under Sections 112(e) and 114, which provide a separate CFR part or subpart with a generally freestanding set of rate and term regulations for each type of licensee. *See* 37 C.F.R. Part 382 (providing separate subparts with complete sets of rate and term regulations for preexisting subscription services and SDARS); 37 C.F.R. Part 384 (a separate part with a complete set of rate and term regulations for business establishment services); *cf.* 37 C.F.R. Part 383 (a separate part with a complete set of rate and term regulations for certain new subscription services, although incorporating by reference certain terms). This structure has worked well, and should be retained in Part 380.

c. Pandora's Second Amended Proposed Rates And Terms Are Riddled With Drafting Anomalies

1247. Pandora's proposed regulations are also riddled with drafting anomalies and plain errors, illustrating the perils of undertaking a major rewrite of complicated regulations in the context of a broad-ranging proceeding employing fast-paced litigation procedures, rather than in a more focused notice-and-comment proceeding. SoundExchange believes that Pandora's proposed changes should be rejected outright, but we identify below a few of these anomalies to illustrate the point.

1248. Throughout its proposed regulations, Pandora has referred to the statutory licenses as provided by 112(e) and 114(d)(2). *E.g.*, Pandora Proposed Regulations, § 380.1(a). Those references are not parallel. The Section 114 statutory license provisions are spread across Section 114(d)(2), (e), (f), (g), (i) and (j).

1249. In its proposed Section 380.2(a), Pandora has capitalized the terms Listener and Listeners, but those terms are not defined.

1250. In its proposed Section 380.3(i)(2), Pandora included a cross reference to paragraph (h)(1). The right reference appears to be paragraph (i)(1).

1251. Pandora moved language concerning the burden of proof for confidentiality exemptions from current Section 380.5(b) to its proposed Sections 380.2(h) and 380.4(a). There is no reason to address this matter twice.

1252. In its proposed Section 380.4(d), Pandora included a cross reference to paragraph (b). As designated by Pandora, the right reference appears to be paragraph (c).

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Respectfully submitted,

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APPENDIX

APPENDIX

TRUE COMPARISON OF REGULATIONS IN PANDORA'S SECOND AMENDED PROPOSED RATES AND TERMS AND THE DRAFT REGULATIONS ACCOMPANYING THE JUDGES' REGULATION DRAFTING LETTER

SUBCHAPTER E — RATES AND TERMS FOR STATUTORY LICENSES

PART 380— RATES AND TERMS FOR ~~CERTAIN ELIGIBLE~~ TRANSMISSIONS BY ELIGIBLE NONSUBSCRIPTION SERVICES AND NEW SUBSCRIPTION SERVICES, AND THE MAKING OF EPHEMERAL REPRODUCTIONS TO FACILITATE THOSE TRANSMISSIONS

SUBPART A— REGULATIONS OF GENERAL APPLICATION

§ 380.1 General.

(a) *Scope*. This part 380 codifies rates and terms of royalty payments for the public performance of sound recordings in certain digital transmissions by Licensees as set forth in this part 380 in accordance with the provisions of 17 U.S.C. 114(d)(2), and the making of Ephemeral Recordings by Licensees in accordance with the provisions of 17 U.S.C. 112(e), during the period January 1, 2016, through December 31, 2020.

(b) *Legal ~~compliance~~Compliance*. Licensees relying upon the statutory licenses set forth in 17 U.S.C. 112~~(e)~~ and 114 shall comply with the requirements of those sections, the rates and terms of this part 380, and any other applicable regulations.

(c) *Voluntary agreements*. ~~Any Copyright Owner and any Licensee may negotiate a voluntary agreement detailing agreeable rates and terms for payment of royalty fees required under the statutory licenses mandated by 17 U.S.C. 112 and 114. The agreed rates and terms within the scope of a negotiated voluntary agreement shall apply to the parties to the agreement~~Notwithstanding the royalty rates and terms established in any subparts of this Subchapter E, the rates and terms of any license agreements entered into by Copyright Owners and Licensees shall apply in lieu of the rates and terms ~~detailed in~~of this part to transmissions within the scope of such agreements.

§ 380.2 Definitions.

For purposes of this part 380, the following definitions shall apply:

(a) *Aggregate Tuning Hours* (ATH) means the total hours of programming that the Licensee has transmitted during the relevant period to all ~~listeners~~Listeners within the United States from all channels and stations that provide audio programming consisting, in whole or in part, of eligible nonsubscription transmissions or noninteractive digital audio transmissions as part of a new subscription service, less the actual running time of any sound recordings for which the Licensee has obtained direct licenses apart from 17 U.S.C. 114(d)(2) or which do not require a license under

United States copyright law. By way of example, if a service transmitted one hour of programming to 10 ~~simultaneous listeners~~Listeners, the service's Aggregate Tuning Hours would equal 10. If 3 minutes of that hour consisted of transmission of a directly licensed recording, the service's Aggregate Tuning Hours would equal 9 hours and 30 minutes. As an additional example, if one ~~listener~~Listener listened to a service for 10 hours (and none of the recordings transmitted during that time was directly licensed), the service's Aggregate Tuning Hours would equal 10.

(b) *Broadcast Retransmissions* means eligible nonsubscription transmissions over the Internet that are retransmissions of terrestrial over-the-air broadcast programming transmitted by the Broadcaster through its AM or FM radio station, including ones with substitute advertisements or other programming occasionally substituted for programming for which requisite licenses or clearances to transmit over the Internet have not been obtained. For the avoidance of doubt, a Broadcast Retransmission does not include programming that does not require a license under United States copyright law or that is transmitted on an Internet-only Side Channel.

(c) *Broadcaster* is a type of Licensee that:

(1) Has a substantial business owning and operating one or more terrestrial AM or FM radio stations that are licensed as such by the Federal Communications Commission;

(2) Has obtained a compulsory license under 17 U.S.C. 112(e) and 114(d)(2) and the implementing regulations therefor to make Eligible Transmissions and related ~~ephemeral recordings~~Ephemeral Recordings;

(3) Complies with all applicable provisions of Sections 112(e) and 114(d)(2) and applicable regulations; and

(4) Is not a noncommercial webcaster as defined in 17 U.S.C. 114(f)(5)(E)(i).

(d) *Broadcaster Webcasts* ~~mean~~means eligible nonsubscription transmissions made by a Broadcaster over the Internet that are not Broadcast Retransmissions.

(e) *Broadcast Retransmissions* mean eligible nonsubscription transmissions made by a Broadcaster over the Internet that are retransmissions of terrestrial over-the-air broadcast programming transmitted by the Broadcaster through its AM or FM radio station, including ones with substitute advertisements or other programming occasionally substituted for programming for which requisite licenses or clearances to transmit over the Internet have not been obtained. For the avoidance of doubt, a Broadcast Retransmission does not include programming that does not require a license under United States copyright law or that is transmitted on an Internet-only side channel.

(f) *Collective* is the collection and distribution organization that is designated by the Copyright Royalty Judges. For the ~~2016-2020 license period~~Rate Period, the Collective is SoundExchange, Inc.

(g) *Commercial Webcaster* is a Licensee, other than ~~a~~an Educational Webcaster, Noncommercial Webcaster, or Public Broadcasting Entities, that makes ephemeral recordings and eligible digital

audio transmissions of sound recordings pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114(d)(2).

(h) *Confidential Information* means the ~~statements~~statement of account and any information contained therein, including the amount of royalty payments, and any information pertaining to the statements of account reasonably designated as confidential by the Licensee submitting the statement. Confidential Information shall not include documents or information that at the time of delivery to the Collective are public knowledge. The party claiming non-confidentiality shall have the burden of proving that the disclosed information was public knowledge.

(i) *Copyright Owners* are sound recording copyright owners who are entitled to royalty payments made under ~~this subpart~~part 380 pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114(d).

(j) *Direct License Share* is the result of dividing (1) a Licensee's Performances of directly licensed sound recordings by (2) the total number of Licensee's Performances of all sound recordings during the payment period.

(k) *Educational Webcaster* means a noncommercial educational broadcast station funded on or after January 1, 1995, under section 396(~~k~~j) of the Communications Act of 1934 (47 U.S.C. 396(~~k~~j)), that transmits solely noncommercial educational and cultural radio programs, and that retransmits, whether or not simultaneously, a nonsubscription terrestrial broadcast.

(l) *Eligible Transmission* shall mean either a ~~Broadcaster Webcast or a Broadcast Retransmission.~~subscription or nonsubscription transmission made by a Licensee that is subject to licensing under 17 U.S.C. 114(d)(2) and the payment of royalties under this part 380.

(m) *Ephemeral Recording* is a digital reproduction created for the purpose of facilitating a transmission of a public performance of a sound recording under a statutory license in accordance with 17 U.S.C. 114, and subject to the limitations specified in 17 U.S.C. 112(e).

(n) *Licensee* is a person that has obtained a statutory license under 17 U.S.C. 114(d)(2), and the implementing regulations, to make eligible nonsubscription transmissions, or noninteractive digital audio transmissions as part of a new subscription service (as defined in 17 U.S.C. 114(j)(8)) ~~other than a Service as defined in § 383.2(h) of this chapter~~, or that has obtained a statutory license under 17 U.S.C. 112(e), and the implementing regulations, to make Ephemeral Recordings for use in facilitating such transmissions~~, but that is not~~

~~(1) A Broadcaster; or~~

~~(2) An Educational Webcaster~~.

(o) *Noncommercial Webcaster* is a Licensee that makes eligible digital audio transmissions and~~:~~

(1) Is exempt from taxation under section 501 of the Internal Revenue Code of 1986 (26 U.S.C. 501),

(2) Has applied in good faith to the Internal Revenue Service for exemption from taxation under section 501 of the Internal Revenue Code and has a commercially reasonable expectation that such exemption shall be granted, or

(3) Is operated by a State or possession or any governmental entity or subordinate thereof, or by the United States or District of Columbia, for exclusively public purposes.

(p) *Performance* is each instance in which any portion of a sound recording is publicly performed ~~publicly~~ to a listener in the United States by means of a digital audio transmission ~~(e.g., the delivery of any portion of a single track from a compact disc to one listener),~~ but excluding the following:

(1) A performance of a sound recording that does not require a license (*e.g.,* a sound recording that is not copyrighted);

(2) A performance of a sound recording for which the service has previously obtained a license from the Copyright Owner of such sound recording; and

(3) An incidental performance that both:

(i) Makes no more than incidental use of sound recordings including, but not limited to, brief musical transitions in and out of commercials or program segments, brief performances during news, talk and sports programming, brief background performances during disk jockey announcements, brief performances during commercials of sixty seconds or less in duration, or brief performances during sporting or other public events~~,~~ and

(ii) Other than ambient music that is background at a public event, does not contain an entire sound recording and does not feature a particular sound recording of more than thirty seconds (as in the case of a sound recording used as a theme song).

(q) *Performers* means the independent administrators identified in 17 U.S.C. 114(g)(2)(B) and (C) and the parties identified in 17 U.S.C. 114(g)(2)(D).

(r) *Proxy Fee* means an administrative fee payable only by Small Broadcasters for waiver of Broadcasters' reporting requirements. The Proxy fee is required to defray the costs to the Collective of developing proxy usage data for purposes of royalty distribution.

~~*Reports of Use* means a monthly report by Licensees to the Collective ..... A Licensee whose royalty rate structure is based upon a per-performance calculation shall file a Report of Use as detailed in this part 380.~~

(s) *Qualified Auditor* is ~~an independent~~a Certified Public Accountant.

(t) *Reports of Use* means a report prepared by or on behalf of a Licensee and delivered to the Collective that identifies the sound recordings transmitted subject to this part 380, and complies with the reporting obligations set forth in 37 C.F.R. 370.4.

(u) *Side Channel* is a channel on the ~~Web~~web site of a Broadcaster ~~that~~, which channel transmits ~~eligible transmissions that the Broadcaster does~~Eligible Transmissions that are not ~~transmit~~ simultaneously transmitted over the air by the Broadcaster.

(v) Small Broadcaster is a Broadcaster that, for any of its channels and stations over which it transmits Broadcast Retransmissions, and for all of its channels and stations over which it transmits Broadcaster Webcasts in the aggregate, in any calendar year in which it is to be considered a Small Broadcaster, meets the following eligibility criteria:

(1) During the prior year it made Eligible Transmissions totaling less than 27,777 Aggregate Tuning Hours; and

(2) During the applicable year it reasonably expects to make Eligible Transmissions totaling less than 27,777 Aggregate Tuning Hours; provided that, one time during the period ~~2011-2015~~2016-2020, a Broadcaster that qualified as a Small Broadcaster under the foregoing definition as of January 31 of one year, elected Small Broadcaster status for that year, and unexpectedly made Eligible Transmissions on one or more channels or stations in excess of 27,777 aggregate tuning hours during that year, may choose to be treated as a Small Broadcaster during the following year notwithstanding paragraph (1) of the definition of "Small Broadcaster" if it implements measures reasonably calculated to ensure that it will not make Eligible Transmissions exceeding 27,777 aggregate tuning hours during that following year. As to channels or stations over which a Broadcaster transmits Broadcast Retransmissions, the Broadcaster may elect Small Broadcaster status only with respect to any of its channels or stations that meet all of the foregoing criteria.

Notwithstanding the terms described for webcasters in this part 380, a Small Broadcaster may be exempt from the reporting requirements by paying an annual Proxy Fee of $100 [for each/all channels and stations?].

§ 380.3 Terms for making payment of royalty fees and delivering statements of account.

(a) *Payment to the Collective.* A Licensee shall make the royalty payments due under this part 380 to the Collective.

(b) *Designation of the Collective.*

(1) Until such time as a new designation is made, SoundExchange, Inc., is designated as the Collective to receive ~~statements~~Statements of ~~account~~Account and royalty payments from Licensees due under this part 380 and to distribute such royalty payments to each Copyright Owner and Performer entitled to receive royalties under 17 U.S.C. 112(e) or 114(g), or their respective designated agents~~,~~.

(2) If SoundExchange, Inc. should dissolve or cease to be governed by a board consisting of equal numbers of representatives of Copyright Owners and Performers, then it shall be replaced by a successor Collective upon the fulfillment of the following requirements. By a majority vote of the nine Copyright Owner representatives and the nine Performer representatives on the SoundExchange board as of the last day preceding the ~~occurrence of either~~ condition precedent, ~~the board~~ in this paragraph (b)(2), such representatives shall file a petition with the Copyright Royalty Judges designating a successor to collect and distribute royalty payments to Copyright Owners and Performers entitled to receive royalties under 17 U.S.C. 112(e) or 114(g) that have themselves authorized the Collective. [?]

(3) The Copyright Royalty Judges shall publish in the *Federal Register* within 30 days of receipt of a petition filed under paragraph (b)(2) of this section an order designating the Collective named in ~~the board's~~such petition.

(c) *Monthly payments*. A Licensee shall make ~~each month~~ any payments due under this part 380 on a monthly basis on or before the 45th day after the end of each month for that month. ~~Licensees shall round all~~All monthly payments shall be rounded to the nearest cent.

(d) *Minimum payments*. A Licensee shall make any minimum payment due under ~~§ 380.3(b)~~ this part 380 by January 31 of the applicable calendar year, except that a Licensee that has not previously made eligible nonsubscription transmissions, noninteractive digital audio transmissions as part of a new subscription service, or Ephemeral Recordings pursuant to the licenses in 17 U.S.C. 114(d)(2) and/or 17 U.S.C. 112(e) shall make any payment due by the 45th day after the end of the month in which the Licensee commences making Ephemeral Recordings or ~~transmissions subject to the statutory licenses~~Eligible Transmissions.

(e) *Election of Small Broadcaster status*. To elect the reporting waiver and to pay the Proxy Fee a Broadcaster must satisfy the requirements for designation as a Small Broadcaster and must submit to the Collective a completed and signed election form on or before January 31, of each applicable year. The Collective will not assume an election; each Small Broadcaster must file a written election for each year in which it qualifies for and chooses Small Broadcaster status. The election form is available at http://www.soundexchange.com.

(f) *Late payments and ~~statements~~Statements of ~~account~~Account*. A Licensee shall pay a late fee of 1.5% per month, or the highest lawful rate, whichever is lower, for any payment ~~and~~/or ~~statement~~Statement of ~~account~~Account received by the Collective after the due date. Late fees shall accrue from the due date until ~~the Collective receives both payment and the related statement of account~~payment and the related Statement of Account are received by the Collective. A single late fee of 1.5% per month shall be due in the event both a payment and statement of account are received by the Collective after the due date, calculated as of the date the later of the two is delivered.

(g) *Statements of ~~account.~~ ~~A Licensee shall remit any~~Account.* Any payment due under this part 380 ~~with~~shall be accompanied by a corresponding ~~statement~~Statement of ~~account~~Account. A ~~statement~~Statement of ~~account~~Account shall contain the following information:

(1) Such information as is necessary to calculate the accompanying royalty payment;

(2) The name, address, business title, telephone number, facsimile number (if any), electronic mail address and other contact information of the person to be contacted for information or questions concerning the content of the statement of account;

(3) The signature of:

(i) The owner of the Licensee or a duly authorized agent of the owner, if the Licensee is not a partnership or corporation;

(ii) A partner or delegee, if the Licensee is a partnership; or

(iii) An officer of the corporation, if the Licensee is a corporation.

(4) The printed or typewritten name of the person signing the Statement of Account;

(5) The date of signature;

(6) If the Licensee is a partnership or corporation, the title or official position held in the partnership or corporation by the person signing the Statement of Account;

(7) A certification of the capacity of the person signing; and

(8) A statement to the following effect:

I, the undersigned [owner/officer/partner/agent] of the Licensee, or officer or partner, have examined this statement of account and hereby state that it is true, accurate, and complete to my knowledge after reasonable due diligence.

This attestation shall not prevent a Licensee may making good faith revisions or adjustments to its Statement of Accounts that it later determines to be necessary to accurately reflect its liabilities due under part 380.

~~(h) *Reports of Use.*~~

~~(1) Educational Webcasters. [Reserved. Agreed terms for Educational Webcasters are set forth in full in subpart C of this part 380.]~~

~~(2) Broadcasters. Broadcasters, except those electing treatment as a Small Broadcaster as described in this part 380, shall submit reports of use on a per performance basis in compliance with the regulations set forth in Subchapter D, part 370, of this chapter, except that the following provisions shall apply notwithstanding the provisions of part 370:~~

~~(i) Broadcasters may pay for, and report usage in, a percentage of their programming hours on an Aggregate Tuning Hours basis if~~

~~(A) Census reporting is not reasonably practical for the programming during those hours; and~~

~~(B) The total number of hours on a single Report of Use is below the yearly annual maximum percentages listed below.~~

~~(I) 2016: __%;~~

~~(II) 2017: __%;~~

~~(III) 2018: __%;~~

~~(IV) 2019: __%;~~

~~(V) 2020: __%.~~

~~To the extent a Broadcaster chooses to report and pay for usage on an Aggregate Tuning Hours basis, the Broadcaster shall:~~

~~(A) Report and pay based on the assumption that the number of sound recordings performed during the relevant programming hours is 12 per hour;~~

~~(B) Pay royalties (or recoup minimum fees) at the per-performance rate described in this part 380 for Broadcasters;~~

~~(C) Include a statement of Aggregate Tuning Hours in the Reports of Use; and~~

~~(D) Include in Reports of Use complete playlist information for usage reported on an Aggregate Tuning Hours basis.~~

~~(ii) Broadcasters shall submit Reports of Use to the Collective on a monthly basis, no later than the 45th day following the last day of the month to which they pertain.~~

~~(iii) Broadcasters that do not qualify for reporting on an Aggregate Tuning Hours basis shall submit Reports of Use to the Collective on a census reporting basis (*i.e.*, Reports of Use shall include every sound recording performed in the relevant month and the number of performances thereof).~~

~~(iv) Broadcasters shall submit a separate report of use for each of their stations, or a collective report of use covering all of their stations *provided* they identify usage on a station-by-station basis;~~

~~(v) Broadcasters shall transmit each Report of Use in a file, the name of which includes:~~

~~(A) The name of the Broadcaster, exactly as it appears on its Notice of Use, and~~

~~(B) If the report covers a single station only, the call letters of the station.~~

~~(vi) Broadcasters shall submit Reports of Use with headers, as presently described in part 370 of this chapter.~~

~~(vii) Broadcasters shall submit a separate Statement of Account corresponding to each Reports of Use, transmitted in a file, the name of which includes:~~

~~(A) The name of the Broadcaster, exactly as it appears on its Notice of Use, and~~

~~(B) If the statement covers a single station only, the call letters of the station.~~

~~(viii) On a transitional basis for a limited time in light of the unique business and operational circumstances currently existing with respect to Small Broadcasters and with the expectation that Small Broadcasters will be required, effective January 1, 2016, to report their actual usage in compliance with then-applicable regulations. Small Broadcasters that have made an election pursuant to paragraph (h) of this section for the relevant year shall not be required to provide reports of their use of sound recordings for Eligible Transmissions and related Ephemeral Recordings. The immediately preceding sentence applies even if the Small Broadcaster actually makes Eligible Transmissions for the year exceeding 27,777 Aggregate Tuning Hours, so long as it qualified as a Small Broadcaster at the time of its election for that year. In addition to minimum royalties hereunder, electing Small Broadcasters will pay to the Collective a $ 100 Proxy Fee to defray costs associated with this reporting waiver, including development of proxy usage data.~~

. . .

(i) *Distribution of royalties.*

(1) The Collective shall promptly distribute ~~promptly to entitled~~royalties received from Licensees to Copyright Owners and Performers that are entitled to such royalties, or their designated agents~~, royalties received from Licensees~~. The Collective shall only be responsible ~~only~~ for making distributions to those Copyright Owners, Performers, or their designated agents who provide the Collective with such information as is necessary to identify the correct recipient. The Collective shall distribute royalties on a basis that values all performances by a Licensee equally based upon the information provided under the Reports of Use requirements for Licensees contained in ~~part 370~~§ 370.4 of this chapter.

(2) If the Collective is unable to locate a Copyright Owner or Performer entitled to a distribution of royalties under paragraph (h)(1) of this section within 3 years from the date ~~the Collective receives the funds~~of payment by a Licensee, such royalties shall be handled in accordance with § ~~380.8.~~380.7.

(j) *Retention of records.* ~~A~~Books and records of a Licensee and of the Collective ~~shall retain for a period of not less than three calendar years after the year for which royalties are paid, the books and records~~ relating to payments of and distributions of royalties shall be kept for a period of not less than the prior 3 calendar years.

§ 380.4 Confidential Information.

(a) The party claiming the benefit of this provision shall have the burden of proving that the disclosed information was public knowledge.

(ab) *Use of Confidential Information.* In no event shall the Collective use any Confidential Information for any purpose other than royalty collection and distribution and activities related directly thereto.

(bc) *Disclosure of Confidential Information.* Access to Confidential Information shall be limited to:

(1) Those employees, agents, attorneys, consultants and independent contractors of the Collective, subject to an appropriate confidentiality agreement, who are engaged in the collection and distribution of royalty payments hereunder and activities related thereto, for the purpose of performing such duties during the ordinary course of their work and who require access to the Confidential Information;

(2) AAn independent and Qualified Auditor, subject to an appropriate confidentiality agreement, who is authorized to act on behalf of the Collective with respect to verification of a Licensee's statement of account pursuant to this part 380 or on behalf of a Copyright Owner or Performer with respect to the verification of royalty distributions pursuant to this part 380;

(3) Copyright Owners and Performers, including their designated agents, whose works a Licensee has used under the statutory licenses set forth in 17 U.S.C. 112(e) and 114(d)(2), subject to an appropriate confidentiality agreement, and including those employees, agents, attorneys, consultants, and independent contractors of such Copyright Owners and Performers and their designated agents, subject to an appropriate confidentiality agreement, who require access to the Confidential Information for the purpose of performing their duties during the ordinary course of their work; and

(4) In connection with future proceedings under 17 U.S.C. 112(e) and 114 before the Copyright Royalty Judges or the courts, and under an appropriate protective order, attorneys, consultants, and other authorized agents of the parties to the proceedings.

(ed) *Safeguarding of Confidential Information.* The Collective and any person identified in paragraph (db) of this section shall implement procedures to safeguard against unauthorized access to or dissemination of any Confidential Information using a reasonable standard of care, but no less than the same degree of security used to protect Confidential Information or similarly sensitive information belonging to the Collective or person.

§ 380.5 Verification of royalty payments.

(a) *Frequency of verification.* The Collective may conduct a single audit of a Licensee, upon reasonable notice and during reasonable business hours, during any given calendar year, for any or

all of the prior 3 calendar years. The Collective may not audit a Licensee's records for any calendar year more than once.

(b) *Notice of intent to audit.* The Collective must file with the Copyright Royalty Judges a notice of intent to audit a particular Licensee, notice of which the Copyright Royalty Judges shall publish in the *Federal Register*, within 30 days of the filing of the notice. The Collective shall ~~delivery~~deliver simultaneously with the filing a copy of the notice of intent to audit to the Licensee to be audited. The audit shall be conducted by ~~the~~an independent and Qualified Auditor identified in the notice, and shall be binding on all parties. A Qualified Auditor must determine the accuracy of royalty payments made to the Collective, including whether an underpayment or overpayment of royalties has been made, and the Qualified Auditor may not be compensated on a contingency fee basis.

(c) *Acceptable verification procedure.* ~~For the purpose of the audit, a~~The Licensee shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit. An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by ~~a~~an independent and Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.

(d) *Consultation.* The Qualified Auditor shall produce a written report to the Collective. Unless the Qualified Auditor has a reasonable basis to suspect fraud on the part of the Licensee, disclosure of which would, in the reasonable opinion of the Qualified Auditor, prejudice investigation of the suspected fraud, the Qualified Auditor shall review tentative written findings of the audit with the appropriate agent or employee of the Licensee in order to remedy any factual errors and clarify any issues relating to the audit before delivering the written report to the Collective. An appropriate agent or employee of the Licensee shall cooperate reasonably with the Qualified Auditor to remedy promptly any factual errors or clarify any issues raised by the audit. The Qualified Auditor shall include in the written report information concerning the cooperation, or the lack thereof, by the Licensee with respect to clarifying issues or correcting factual errors.

(e) *Costs of the verification procedure.* The Collective shall pay the cost of the verification procedure, unless ~~the audit process concludes with a report of~~it is finally determined that there was an underpayment ~~by the Licensee~~ of 10% or more, in which case the Licensee shall bear the reasonable costs of the verification procedure, in addition to paying the amount of any underpayment.

(f) *Make-up payments or credits.* Upon the conclusion of the verification and the resolution of all claims between the Collective and the Licensee, (1) the Licensee shall, in the case of any underpayment, remit the amount of any agreed-upon underpayment to the Collective, as mutually agreed by the Collective and the Licensee, which agreement may, but need not, include installment payments, with interest, at the rate specified in § 380.3(e), and (2) the Collective shall, in the case of any overpayment, credit the account of the Licensee in the amount of any agreed upon overpayment to the Collective, with interest, at the rate specified in § 380.3(e).

(g) *Acquisition and retention of report.* The Collective shall retain the report of the verification for a period of not less than 3 years ~~after the date of the report~~.

§ 380.6 Verification of royalty distributions.

(a) *Frequency of verification.* A Copyright Owner or Performer may conduct a single audit of the Collective, upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior 3 calendar years. A Copyright Owner or Performer may not audit the Collective's records for any calendar year more than once.

(b) *Notice of intent to audit.* A Copyright Owner or Performer must file with the Copyright Royalty Judges a notice of intent to audit the Collective, notice of which the Copyright Royalty Judges shall publish in the Federal Register, within 30 days of the filing of the notice. The Copyright Owner or Performer shall deliver a copy of the notice of intent to audit to the Collective simultaneously with the filing. The audit shall be conducted by the Qualified Auditor identified in the notice, and shall be binding on all parties.

(c) *Acceptable verification procedure.* For the purposes of the audit, the Collective shall use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit. An audit, including underlying paperwork, performed in the ordinary course of business according to generally accepted auditing standards by a Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.

(d) *Consultation.* The Qualified Auditor shall produce a written report to the Copyright Owner or Performer. Unless the Qualified Auditor has a reasonable basis to suspect fraud on the part of the Collective, disclosure of which would, in the reasonable opinion of the Qualified Auditor, prejudice investigation of the suspected fraud, the Qualified Auditor shall review tentative written findings of the audit with the appropriate agent or employee of the Collective in order to remedy any factual errors and clarify any issues relating to the audit before delivering the written report to the Copyright Owner or Performer. An appropriate agent or employee of the Collective shall cooperate reasonably with the Qualified Auditor to remedy promptly any factual errors or clarify any issues raised by the audit. The Qualified Auditor shall include in the written report information concerning the cooperation, or the lack thereof, by the Collective with respect to clarifying issues or correcting factual errors.

(e) *Costs of the verification procedure.* The Copyright Owner or Performer requesting the verification procedure shall pay the cost of the procedure, unless it is finally determined that there was an underpayment of 10% or more, in which case the Collective shall bear the reasonable costs of the verification procedure, in addition to paying the amount of any underpayment.

(f) *Acquisition and retention of report.* The Copyright Owner or Performer requesting the verification procedure shall retain the report of the verification for a period of not less than 3 years after the date of the report.

§ ~~380.8~~380.7 Unclaimed ~~funds~~Funds.

If the Collective is unable to identify or locate a Copyright Owner or Performer ~~purported to be~~who is entitled to receive a royalty distribution under this ~~part 380~~subpart, the Collective shall retain the required payment in a segregated trust account for a period of 3 years ~~after~~from the date of final distribution of all royalties ~~relating to the year of the licensed transmission. No Copyright Owner or Performer shall have a valid~~. No claim to such distribution shall be valid after the expiration of the 3-year period. After expiration of this period, the Collective ~~may apply the unclaimed funds to offset any costs deductible under 17 U.S.C. 114(g)(3). The foregoing shall apply notwithstanding the~~shall handle such funds in accordance with applicable common law or ~~statutes of any~~ State law.

SUBPART B – APPLICABLE ROYALTY RATES FOR THE ~~TERM~~RATE PERIOD JANUARY 1, 2016, THROUGH DECEMBER 31, 2020.

§ ~~380.10~~380.8 Royalty fees for the public ~~performance~~Performance of sound recordings and ~~for ephemeral recordings~~the making of Ephemeral Recordings by Commercial Webcasters.

(a) ***Royalty rates.*** Royalty rates for the making of Eligible Transmissions and Ephemeral Recordings by Commercial Webcasters are as follows:

(i) For all nonsubscription Eligible Transmissions and the making of Ephemeral Recordings to facilitate such nonsubscription Eligible Transmissions, the greater of the following:

(A) For 2016, 25% of Revenue or $0.00110 [$.00120] per Performance[2]

(B) For 2017, 25% of Revenue or $0.00112 [$.00123] per Performance

(C) For 2018, 25% of Revenue or $0.00114 [$.00125] per Performance

(D) For 2019, 25% of Revenue or $0.00116 [$.00127] per Performance

(E) For 2020, 25% of Revenue or $0.00118 [$.00129] per Performance

(ii) For all subscription Eligible Transmissions and the making of Ephemeral Recordings to facilitate such subscription Eligible Transmissions, the greater of the following:

(A) For 2016, 25% of Revenue or $0.00215 [$.00224] per Performance

(B) For 2017, 25% of Revenue or $0.00218 [$.00228] per Performance

(C) For 2018, 25% of Revenue or $0.00222 [$.00232] per Performance

[2] The bracketed figures represent the high end of the rate range proposed by Pandora.

(D) For 2019, 25% of Revenue or $0.00226 [$.00236] per Performance

(E) For 2020, 25% of Revenue or $0.00230 [$.00240] per Performance

(2) The determination of whether a Commercial Webcaster shall pay according to Revenue or Performances in subsection (2)(i) or 2(ii) above for a given payment period shall be made with respect to all Performances, regardless of whether Licensee has licensed any such Performances directly from the Copyright Owner or an agent of the Copyright Owner. If, after such determination, the Commercial Webcaster is subject to paying royalties on Performances, then it need not make a payment pursuant to subsection (2)(i) or (2)(ii) for any directly licensed Performances or Performances of sound recordings fixed before February 15, 1972. If, after such determination, the Commercial Webcaster is subject to paying royalties on Revenues, then the fee owed may, prior to payment, be reduced by the Direct License Share.

(3) For purposes of this section 380.8, "*Revenue*" means all money earned by a Licensee consistent with Generally Accepted Accounting Principles ("GAAP"), which is derived by the Licensee from making Eligible Transmissions in the United States, and shall be comprised of the following:

(i) Subscription revenue earned by a Licensee directly from U.S. subscribers for making Eligible Transmissions; and

(ii) Licensee's advertising revenues, or other monies received from sponsors, if any, attributable to advertising on channels making Eligible Transmissions, other than those that use only incidental performances of sound recordings, less advertising agency and sales commissions. For the avoidance of doubt, Revenue shall exclude revenue from activities other than making Eligible Transmissions, as well as sales and use taxes, shipping and handling, credit card, invoice, and fulfillment service fees.

(~~a~~b) *Ephemeral ~~recordings~~Recordings*. The royalty payable under 17 U.S.C. 112(e) for the making of all Ephemeral Recordings used by the Licensee solely to facilitate transmissions ~~for which it pays royalties~~made pursuant to 17 U.S.C. 114 shall be included within, and constitute 5% of, the total royalties payable under 17 U.S.C. 112(e) and 114. A Licensee is authorized to make more than one Ephemeral Recording of a sound recording as it deems necessary to make noninteractive digital audio transmissions pursuant to 17 U.S.C. 114.

(~~b~~c) *Minimum Fee*. ~~All Licensees transmitting sound recordings under this part 380 shall pay a minimum annual fee.~~ Each Commercial Webcaster will pay an annual, nonrefundable minimum fee of $500 for each calendar year or part of a calendar year during which it is a Licensee. The annual minimum fee is payable for each individual channel and each individual station transmitted by such Commercial Webcaster pursuant to 17 U.S.C. 114(d)(2), provided that a Commercial Webcaster shall not be required to pay more than $50,000 per calendar year in minimum fees in the aggregate (for 100 or more channels or stations). The amount of the minimum fee shall be applied as a credit against additional royalty fees payable in the same calendar year.

(1) Commercial Webcasters. Each Commercial Webcaster shall pay an annual, nonrefundable minimum fee of $ 500 for each calendar year or part of a calendar year of the period 2016-2020 during which it is a Licensee. The annual minimum fee is payable for each individual channel and each individual station maintained [or operated?] by Commercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are Commercial Webcasters, provided that a Commercial Webcaster shall not be required to pay more than $ 50,000 per calendar year in minimum fees in the aggregate (for 100 or more channels or stations).

(2) Noncommercial Webcasters. Each Noncommercial Webcaster shall pay an annual, nonrefundable minimum fee of $ 500 for each calendar year or part of a calendar year of the period 2016-2020 during which it is a Licensee. The annual minimum fee is payable for each individual channel and each individual station maintained [or operated?] by Noncommercial Webcasters, and is also payable for each individual Side Channel maintained by Broadcasters who are Noncommercial Webcasters.

(3) Educational Webcasters. [Reserved. Agreed terms for Educational Webcasters are set forth in full in subpart C of this part 380.]

(3) Broadcasters. Each Broadcaster shall pay an annual, nonrefundable minimum fee of $ 500 for each of its individual channels, including each of its individual side channels, and each of its individual stations, through which (in each case) it makes Eligible Transmissions, for each calendar year or part of a calendar year during 2016-2020 during which the Broadcaster is a Licensee, provided that a Broadcaster shall not be required to pay more than $ 50,000 in minimum fees in the aggregate (for 100 or more channels or stations). For the purpose of this subpart, each individual stream (*e.g.*, HD radio side channels, different stations owned by a single Licensee) shall be treated separately and be subject to a separate minimum, except that identical streams for simulcast stations shall be treated as a single stream if the streams are available at a single Uniform Resource Locator (URL) and if performances from all simulcast stations are aggregated for purposes of determining the number of payable performances under this part 380.

(c) *Proxy Fee*. A Small Broadcaster or an Educational Webcaster may elect to pay a $ 100 annual Proxy Fee [for each station or channel? Or per parent?] to the Collective for the reporting waiver discussed in _____.

(d) *Applicable Rates*.

(1) Commercial Webcasters. For all digital audio transmissions, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, and related Ephemeral Recordings, a Commercial Webcaster shall pay a royalty of: [$ 0.____ per performance for 2016; $ 0.____ per performance for 2017; $ 0.____ per performance for 2018; $ 0.____ per performance for 2019; and $ 0.____ per performance for 2020].

(2) Noncommercial Webcasters.

(i) For all digital audio transmissions totaling not more than 159,140 Aggregate Tuning Hours (ATH) in a month, including simultaneous digital audio retransmissions of over-the-air AM or FM

~~radio broadcasts, and related Ephemeral Recordings, a Noncommercial Webcaster shall pay an annual per channel or per station performance royalty of [$ 500 in 2016, 2017, 2018, 2019, and 2020].~~

~~(ii) For all digital audio transmissions totaling in excess of 159,140 Aggregate Tuning Hours (ATH) in a month, including simultaneous digital audio retransmissions of over-the-air AM or FM radio broadcasts, and related Ephemeral Recordings, a Noncommercial Webcaster will pay a royalty of: $ 0.0019 per performance for 2011; $ 0.0021 per performance for 2012; $ 0.0021 per performance for 2013; $ 0.0023 per performance for 2014; and $ 0.0023 per performance for 2015.~~

~~(3) Educational Webcasters. If, in any month, an Educational Webcaster makes total transmissions in excess of 159,140 Aggregate Tuning Hours on any individual channel or station, the Educational Webcaster shall pay additional usage fees ("Usage Fees") for the Eligible Transmissions it makes on that channel or station after exceeding 159,140 total ATH at the following per-performance rates.~~

~~(i) 2016: $ 0.0017;~~

~~(ii) 2017: $ 0.0020;~~

~~(iii) 2018: $ 0.0022;~~

~~(iv) 2019: $ 0.0023;~~

~~(v) 2020: $ 0.0025.~~

~~For an Educational Webcaster unable to calculate actual total performances and not required to report ATH or actual total performances under § 380.23(g)(3), the Educational Webcaster may pay its Usage Fees on an ATH basis, provided that the Educational Webcaster shall pay its Usage Fees at the per-performance rates provided in paragraphs (b)(1) through (5) of this section based on the assumption that the number of sound recordings performed is 12 per hour. The Collective may distribute royalties paid on the basis of ATH hereunder in accordance with its generally applicable methodology for distributing royalties paid on such basis. In addition, and for the avoidance of doubt, an Educational Webcaster offering more than one channel or station shall pay Usage Fees on a per-channel or -station basis.~~

~~(4) Broadcasters. Broadcasters not exempt from census reporting as provided in § 380.3(h), shall pay on a [per-performance] basis for Eligible Transmissions and Ephemeral Recordings, as follows,~~

~~(i) 2016: $ 0.____;~~

~~(ii) 2017: $ 0.____;~~

~~(iii) 2018: $ 0.____;~~

~~(iv) 2019: $ 0.____;~~

~~(v) 2020: $ 0.____.~~

§ 380.9 Royalty fees for the public Performance of sound recordings and the making of Ephemeral Recordings by Broadcasters [[*if different than for Commercial Webcasters*]]

~~....~~

~~**SUBPART C – APPLICABLE ROYALTY RATES AND TERMS FOR EDUCATIONAL WEBCASTERS FOR THE PERIOD JANUARY 1, 2016, THROUGH DECEMBER 31, 2020.**~~

~~[INSERT HERE THE SX/CBI AGREEMENT.]~~

~~**SUBPART D – CERTAIN TRANSMISSIONS BY PUBLIC BROADCASTING ENTITIES**~~

~~[INSERT HERE THE SX/PUBLIC BROADCASTING AGREEMENT, if and when approved.]~~

§ 380.10 Royalty fees for the public Performance of sound recordings and the making of Ephemeral Recordings by Commercial Webcasters.

~~...~~

COS

CERTIFICATE OF SERVICE

I hereby certify that on July 15, 2015, I caused a copy of the foregoing – PUBLIC **1) REPLY FINDINGS OF FACT OF SOUNDEXCHANGE, INC., and 2) REPLY CONCLUSIONS OF LAW OF SOUNDEXCHANGE, INC.** to be served via electronic mail and first-class, postage prepaid, United States mail, addressed as follows:

Kurt Hanson AccuRadio, LLC 65 E. Wacker Place, Suite 930 Chicago, IL 60601 kurt@accuradio.com Telephone: (312) 284-2440 Facsimile: (312) 284-2450 *AccuRadio, LLC*	George D. Johnson, an individual d.b.a. Geo Music Group 23 Music Square East, Suite 204 Nashville, TN 37203 E-mail: george@georgejohnson.com Telephone: (615) 242-9999 *George D. Johnson (GEO), an individual and digital sound recording copyright creator d.b.a. Geo Music Group*
Kevin Blair Brian Gantman Educational Media Foundation 5700 West Oaks Boulevard Rocklin, CA 95765 kblair@kloveair1.com bgantman@kloveair1.com Telephone: (916) 251-1600 Facsimile: (916) 251-1731 *Educational Media Foundation*	Donna K. Schneider Associate General Counsel, Litigation & IP iHeartMedia, Inc. 200 E. Basse Rd. San Antonio, TX 78209 DonnaSchneider@iheartmedia.com Telephone: (210) 832-3468 Facsimile: (210) 832-3127 *iHeartMedia, Inc.*
Frederick Kass Intercollegiate Broadcasting System, Inc. (IBS) 367 Windsor Highway New Windsor, NY 12553-7900 ibs@ibsradio.org ibshq@aol.com Telephone: (845) 565-0003 Facsimile: (845) 565-7446 *Intercollegiate Broadcasting System, Inc. (IBS)*	Russ Hauth, Executive Director Harv Hendrickson, Chairman 3003 Snelling Avenue, North Saint Paul, MN 55113 russh@salem.cc hphendrickson@unwsp.edu Telephone: (651) 631-5000 Facsimile: (651) 631-5086 *National Religious Broadcasters NonCommercial Music License Committee (NRBNMLC)*

Gregory A. Lewis National Public Radio, Inc. 1111 North Capital Street, NE Washington, DC 20002 glewis@npr.org Telephone: (202) 513-2050 Facsimile: (202) 513-3021 *National Public Radio, Inc. (NPR)*	Patrick Donnelly Sirius XM Radio, Inc. 1221 Avenue of the Americas 36th Floor New York, NY 10020 patrick.donnelly@siriusxm.com Telephone: (212) 584-5100 Facsimile: (212) 584-5200 *Sirius XM Radio Inc.*
Cynthia Greer Sirius XM Radio, Inc. 1500 Eckington Place, NE Washington, DC 20002 cynthia.greer@siriusxm.com Telephone: (202) 380-1476 Facsimile: (202) 380-4592 *Sirius XM Radio Inc.*	Christopher Harrison Pandora Media, Inc. 2101 Webster Street, Suite 1650 Oakland, CA 94612 charrison@pandora.com Telephone: (510) 858-3049 Facsimile: (510) 451-4286 *Pandora Media, Inc.*
David Oxenford WILKINSON BARKER KNAUER, LLP 2300 N Street, NW, Suite 700 Washington, DC 20037 doxenford@wbklaw.com Telephone: (202) 373-3337 Facsimile: (202) 783-5851 *Counsel for Educational Media Foundation and National Association of Broadcasters (NAB)*	Jeffrey J. Jarmuth Law Offices of Jeffrey J. Jarmuth 34 E. Elm Street Chicago, IL 60611-1016 Telephone: (312) 335-9933 Facsimile: (312) 822-1010 Jeff.jarmuth@jarmuthlawoffices.com *Counsel for AccuRadio, LLC*
William Malone 40 Cobbler's Green 205 Main Street New Canaan, CT 06840 Malone@ieee.org Telephone: (203) 966-4770 *Counsel for Harvard Radio Broadcasting Co., Inc. (WHRB) and Intercollegiate Broadcasting System, Inc. (IBS)*	Bruce Joseph, Karyn Ablin Michael Sturm, Jillian Volkmar WILEY REIN LLP 1776 K Street, NW Washington, DC 20006 bjoseph@wileyrein.com kablin@wileyrein.com msturm@wileyrein.com JVolkmar@wileyrein.com Telephone: (202) 719-7000 Facsimile: (202) 719-7049 *Counsel for National Association of Broadcasters (NAB)*

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